

Department of Revenue

Marijuana Enforcement Division

Performance Audit
July 2023
2255P



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July 25, 2023

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Marijuana Enforcement Division (Division) in the Department of Revenue (Department). The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government, and Section 2-7-204(5), C.R.S., which requires the State Auditor to annually conduct performance audits of one or more specific programs or services in at least two departments for purposes of the SMART Government Act. The report presents our findings, conclusions, and recommendations, and the responses of the Division and Department.





Report Highlights

Marijuana Enforcement Division

Department of Revenue • Performance Audit • July 2023 • 2255P

Key Concern

The Marijuana Enforcement Division (Division), within the Department of Revenue (Department), could improve its processes for prioritizing retail marijuana store inspections, taking enforcement action when investigations identify evidence that marijuana laws and rules may have been violated, and procuring its seed-to-sale marijuana inventory tracking system.

Key Findings

- Between Fiscal Years 2019 and 2022, the Division did not inspect 36 percent of newly-licensed retail marijuana stores (40 out of 112 newly-licensed stores) within 1 year of approving those licenses; Division policy states that it will strive to inspect them all within 1 year of licensure.
- The Division did not conduct targeted inspections on some businesses that met risk factors. Between Fiscal Years 2019 and 2022, the Division did not inspect 182 of the 567 licensed retail marijuana stores (32 percent) that appeared on at least one monthly targeted inspection report because they had never been inspected or had not been inspected within the past 2 years. Of the 182 stores, 75 were stores that had never been inspected, while the Division inspected other stores multiple times, such as one store the Division inspected 19 times during that 4-year period.
- The Division completed at least one underage compliance check for 554 of the 629 (88 percent) retail marijuana stores after the stores appeared on at least one monthly underage compliance check report during the period reviewed. The other 75 stores did not undergo an underage compliance check after appearing on a report that identified them as a priority due to risk.
- Division investigators did not consistently cite retail marijuana stores for all violations associated with marijuana sales to underage individuals. Of the seven stores reviewed that were cited for selling marijuana to an underage operative, only six were also cited for failing to verify the operative's age, five were cited for allowing the operative into a restricted access area where marijuana is sold, and three were cited for transferring marijuana to a customer without a valid ID. Typically, underage marijuana sales should be a violation of each of these regulatory requirements.
- The Division did not pursue any disciplinary action against the stores for 23 of 44 violations of marijuana laws and rules that affected public safety (e.g., violations associated with marijuana sales to underage individuals and inventory tracking issues) in our sample.
- The Department's documentation justifying its decision to award a sole source contract in 2018 for the ongoing support, licensing, and hosting of the METRC system did not address why METRC was the only system on the market that could meet the Department's needs and why the Department did not need to pursue a competitive bidding process, as required.

Background

- In 2012, Colorado voters approved Amendment 64, which authorized personal use of marijuana, also referred to as "retail marijuana." Adults age 21 and older can purchase retail marijuana at licensed stores.
- The Division is responsible for regulating Colorado's retail marijuana industry, including issuing business licenses, inspecting marijuana stores, investigating alleged violations of marijuana laws and rules, and pursuing enforcement actions.
- The Division conducts targeted inspections that focus on specific compliance components of a licensed store's premises, as well as underage compliance checks that involve operatives under 21 years old who attempt to buy marijuana from a licensed retail store. To help prioritize its investigations, the Division generates monthly targeted and underage compliance check reports listing stores that may be at greater risk of noncompliance with marijuana laws and rules.
- METRC is the Department's system that tracks regulated marijuana from either the seed or immature plant stage until the regulated marijuana or regulated marijuana product is sold.

Recommendations Made

6

Responses

Agree: 6

Partially Agree: 0

Disagree: 0



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Chapter 1

Overview of Marijuana Regulation

Marijuana was legalized in Colorado through the passage of two citizen ballot initiatives that amended the Colorado Constitution. In 2000, voters passed Amendment 20 that added Section 14 to Article XVIII, authorizing the medical use of marijuana for those suffering from certain medical conditions. In 2012, voters passed Amendment 64 that added Section 16 to Article XVIII, authorizing personal use of marijuana, also referred to as “retail marijuana.” Amendment 64 also required the State to establish a regulatory structure for retail marijuana and expressed the voters’ intent that “marijuana should be regulated in a manner similar to alcohol so that individuals will have to show proof of age before purchasing marijuana; selling, distributing, or transferring marijuana to minors and other individuals under the age of twenty-one shall remain illegal; driving under the influence of marijuana shall remain illegal; legitimate, taxpaying business people, and not criminal actors, will conduct sales of marijuana; and marijuana sold in this state [Colorado] will be labeled and subject to additional regulations to ensure that consumers are informed and protected” [Colorado Const., Art. XVIII, Sec. 16(1)(b)]. On January 1, 2014, the sale of retail marijuana became legal in Colorado, except in areas where local governments prohibit retail marijuana businesses through an enactment of an ordinance or referred measure.

The General Assembly also enacted legislation to implement the constitutional provisions adopted by voters, including requirements for how marijuana should be regulated. In 2019, Senate Bill 19-224 combined laws related to medical and retail marijuana into the Colorado Marijuana Code. The Colorado Marijuana Code is scheduled for repeal on September 1, 2028. Prior to that date, the Department of Regulatory Agencies is required to conduct a sunset review [Sections 44-10-1401 and 24-34-104(5), C.R.S.].

Oversight of Retail Marijuana

The Colorado Constitution requires the Department of Revenue (Department) to “adopt regulations necessary for implementation” of retail marijuana [Colorado Const., Art. XVIII, Sec. 16 (5)(a)]. These regulations must include standards and procedures for licensing marijuana businesses and their employees, requirements to prevent marijuana sales to individuals under age 21, civil penalties for regulatory violations, and health and safety regulations [Colorado Const., Art. XVIII, Sec. 16(5)(a) and Section 44-10-202(1), C.R.S.]. Statute further grants the State Licensing Authority, defined as the Executive Director of the Department, authority to “promulgate rules for the proper regulation and control of the cultivation, manufacture, distribution, sale, and testing of regulated marijuana and regulated marijuana products” and for the enforcement of the Colorado Marijuana

Code [Section 44-10-202(1)(c), C.R.S.]. Regulated marijuana is defined as “medical marijuana and retail marijuana” concentrate and products [Section 44-10-103(54), C.R.S.].

The Executive Director employs officers and employees in the Marijuana Enforcement Division (Division) to carry out the State Licensing Authority’s responsibilities [Section 44-10-201(2), C.R.S.]. The Division’s mission statement is “to promote public safety and reduce public harm by regulating the Colorado commercial marijuana industry through consistent administration of laws, regulations and strategic integration of process management, functional expertise, and innovative problem-solving.”

Regulatory Activities

The Division’s regulatory functions include:

- Developing and maintaining a seed-to-sale tracking system that tracks regulated marijuana from either the seed or immature plant stage until the regulated marijuana or regulated marijuana product is sold.
- Granting or refusing state licenses to businesses and employees involved with the cultivation, manufacture, distribution, sale, hospitality, and testing of regulated marijuana and regulated marijuana products.
- Investigating alleged violations of marijuana laws and rules and pursuing enforcement actions.
- Approving vendors to provide responsible retail marijuana vendor server and seller training programs.
- Reporting annually on the discharge of its duties [Section 44-10-201, C.R.S.].

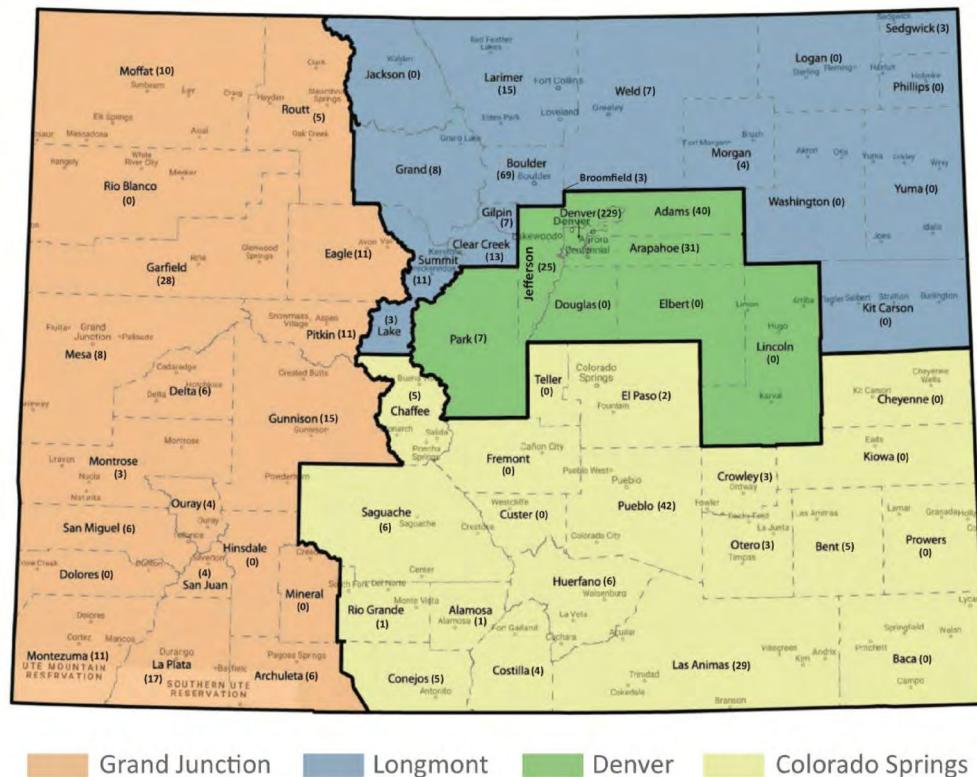
From Fiscal Year 2019 to 2022, there were 733 retail marijuana stores with approved state licenses. In Colorado, businesses must be issued a license by both the State and a local licensing authority [Colorado Const., Art. XVIII, Sec. 16(5)(e) and Section 44-10-305(2)(b)(I), C.R.S.]. All individuals who own or work for a licensed marijuana business must pass a fingerprint-based criminal history background check and demonstrate Colorado residency; in addition, business owners must demonstrate financial responsibility in order to receive a State-issued license. Marijuana businesses must also document their funding sources and ownership structure.

The Division handles some functions, such as licensure, centrally from its headquarters office in the Denver metropolitan area. In addition, the Division has divided the state into four enforcement regions, which are responsible for inspecting the marijuana businesses, including retail marijuana stores, located in those areas. Each region has a field office with an agent in charge who oversees the

region's inspection priorities and responsibilities. The four regional field offices are located in Denver, Colorado Springs, Longmont, and Grand Junction. Exhibit 1.1 shows the Division's four enforcement regions and the number of retail marijuana stores in each county during Fiscal Years 2019 through 2022.

Exhibit 1.1

State-Licensed Retail Marijuana Stores by County¹, Fiscal Years 2019 through 2022²



Source: Office of the State Auditor analysis of Division data.

¹ Counties showing no stores include both counties with legalized marijuana but no licensed stores, and counties that have prohibited retail marijuana through local ordinances.

² Includes stores that had approved state licenses at any time during Fiscal Years 2019 through 2022.

The Division was appropriated 153.1 full-time-equivalent staff and a budget of \$16.8 million for Fiscal Year 2023. This includes staff who handle licensing, data analysis, and legal assistance for the Division, as well as about 50 investigators who work in the Division's four regional offices. The Division is funded by medical and retail marijuana license fees that are paid into the Marijuana Cash Fund.

Anyone can submit a complaint about a retail marijuana business to the Division using an online form on the Division's website. The form has several sections for the complainant to complete, such as contact information, product name, and information about the retail store. The form can be used to report on several circumstances, including adverse health events associated with marijuana use or alleged violations of marijuana laws or rules. Division investigators also receive complaints directly

through email, in person, and over the phone. For Fiscal Years 2019 through 2022, the Division received at least 1,096 complaints about retail marijuana stores that were submitted via the Division’s phone line and online complaint submission form.

Data Systems

The Division uses two data systems to document information about retail marijuana businesses and its regulatory activities.

METRC

Statute requires the Division to “develop and maintain a seed-to-sale tracking system that tracks regulated marijuana from either the seed or immature plant stage until the regulated marijuana or regulated marijuana product is sold” [Section 44-10-202(1)(a), C.R.S.]. Department rules further require the seed-to-sale tracking system to be a “web-based tool coupled with [Radio Frequency Identification] RFID technology” that allows both the Division and licensed marijuana business users the ability to identify and account for all regulated marijuana [1 CCR 212-3, Rule 3-800]. To fulfill these requirements, the Department contracts with Metrc LLC (formerly known as Franwell) to provide the Marijuana Enforcement Tracking Reporting Compliance (METRC) system. All licensed marijuana businesses are required to track on-premises and in-transit regulated marijuana inventories each day in METRC [1 CCR 212-3, Rule 3-805(E)]. The Division can then use METRC to monitor and track regulated marijuana inventory. The system also provides a platform for the Division to exchange information with and provide compliance notifications to the marijuana industry.

My License Office (MyLO)

The Division uses a Department system called My License Office (MyLO) to track information about licensed marijuana businesses and employees, complaints the Division receives about marijuana businesses, and Division investigations. Division staff enter data into MyLO, and there is an automated interface between MyLO and METRC that transmits licensing information from MyLO to METRC on a daily basis.

Retail Marijuana Tax

Retail marijuana is subject to two state taxes: a 15 percent sales tax on all sales of retail marijuana and retail marijuana products, and a 15 percent excise tax on transfers of retail marijuana from a retail marijuana cultivation facility to a retail marijuana product manufacturing facility or a retail marijuana store [Sections 39-28.8-202 and 39-28.8-302, C.R.S.]. Total marijuana sales have decreased in recent years, from approximately \$2.2 billion in Calendar Year 2020 to \$1.8 billion in Calendar

Year 2022. In Fiscal Year 2022, the State collected \$259 million in retail marijuana sales tax and \$99 million in retail marijuana excise tax.

Revenue from retail marijuana sales tax is distributed to local governments, the State Public School Fund, the General Fund, and the Marijuana Tax Cash Fund, while revenue from the excise tax is distributed to the Public School Capital Construction Assistance Fund [Sections 39-28.8-203(1)(a), 39-28.8-203(1)(b)(I.5), and 39-28.8-305(1)(a)(III), C.R.S.]. The General Assembly may appropriate money in the Marijuana Tax Cash Fund to the Department for the direct and indirect costs associated with implementing the marijuana tax laws and Colorado Marijuana Code. In addition, funds in the Marijuana Tax Cash Fund can be used for a variety of specific purposes approved by the General Assembly, including, but not limited to, education about marijuana to prevent its illegal use or legal abuse, treatment for those with substance use or mental health disorders, drug take-back programs, marijuana related research, rental assistance, and veteran service-to-career programs [Sections 39-28.8-501(2)(a) and 29-28.8-501(2)(b)(IV), C.R.S.].

Audit Purpose, Scope, and Methodology

We conducted this performance audit pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of the state government, and Section 2-7-204(5), C.R.S., the State Measurement for Accountable, Responsive, and Transparent (SMART) Government Act. The audit was conducted in response to a legislative request, which expressed concerns regarding a reduction in the number of underage compliance checks that the Division conducted in recent years, as well as concerns with the procurement process for the Division's current contract for a seed-to-sale tracking system. Audit work was performed from August 2022 through July 2023, and we appreciate the cooperation and assistance provided by Department and Division management and staff.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The key objectives of the audit were to assess whether the Division:

- Prioritizes and conducts inspections of licensed retail marijuana stores, including underage compliance checks, in accordance with its risk-based investigation system. Our work included analyzing trends in the number of underage compliance checks and in-person inspections that the Division conducted prior to, during, and after the COVID-19 pandemic.

- Has an effective process to address complaints about retail marijuana stores that may have violated regulatory requirements and reports of adverse health events associated with retail marijuana use.
- Has an effective process to verify that retail marijuana stores comply with requirements for retail marijuana sales, pursues appropriate enforcement actions when investigations identify evidence of violations, and publicly reports information about investigations and enforcement actions in accordance with requirements.
- Complied with state requirements when procuring its most recent contract for a seed-to-sale marijuana inventory tracking system.

To accomplish our audit objectives, we performed the following audit work:

- Reviewed applicable laws; rules; and Division policies, procedures, and guidance.
- Interviewed Department and Division staff and management, conducted site visits to all four regional offices to interview staff and observe investigators inspect retail marijuana businesses, and observed underage compliance checks.
- Analyzed aggregate licensing, complaint, and investigation data from MyLO for retail marijuana stores that had active licenses from July 2018 through June 2022.
- Analyzed monthly reports dated July 2018 through June 2022 that Division staff generated to list retail marijuana stores that should have been considered for inspections and underage compliance checks by investigators.
- Reviewed procurement and contract documents relevant to the 2018 contract awarded to Metrc LLC to provide ongoing support, licensing, and hosting services for METRC. This included documentation related to justifying a sole source procurement, email correspondence, contracts, contract amendments, and historical documents related to the 2011 contract awarded to Metrc LLC.
- Researched companies that provided seed-to-sale marijuana inventory tracking systems to other states with legalized marijuana as of 2018.

We relied on the following nonstatistical samples to support our audit work:

- A stratified random sample of 25 complaints selected from retail marijuana stores with active licenses from July 2020 through June 2022. The complaint population was divided into the four enforcement regions, and five complaints were randomly selected from each of the four regions, which amounted to 20 of the sampled complaints. The remaining five complaints related to

adverse health events associated with marijuana use were selected from the overall population of complaints, regardless of region. The audit team assessed how the regions addressed the sampled complaints and reviewed the Division's process for deciding whether to investigate the adverse health event complaints.

- A stratified random sample of 20 inspections that were conducted at retail marijuana stores with active licenses from July 2020 through May 2022. The sample included 10 inspections that resulted in a criminal filing or entered the disciplinary process and 10 inspections that resulted in no criminal filing and did not enter the disciplinary process.

The results of our nonstatistical samples cannot be projected to the population. However, the sample results are valid for confirming inconsistencies in the Division's enforcement process and, along with the other audit work performed, provide sufficient, reliable evidence as the basis for our findings, conclusions, and recommendations.

As required by auditing standards, we planned our audit work to assess the effectiveness of those internal controls that were significant to our audit objectives. Details about the audit work supporting our findings and conclusions, including any deficiencies in internal control that were significant to our audit objectives, are described in the remainder of this report.

A draft of this report was reviewed by the Division and Department. Obtaining the views of responsible officials is an important part of the Office of the State Auditor's (OSA) commitment to ensuring that the report is accurate, complete, and objective. The OSA was solely responsible for determining whether and how to revise the report, if appropriate, based on the Division's and Department's comments. The written responses to the recommendations and the related implementation dates were the sole responsibility of the Division.



Chapter 2

Regulation of Retail Marijuana

The Marijuana Enforcement Division’s (Division) mission is to “promote public safety and reduce public harm by regulating the Colorado commercial marijuana industry through consistent administration of laws, regulations and strategic integration of process management, functional expertise, and innovative problem-solving.” As a part of the Division’s work to fulfill its mission, the Division created processes (1) to help the four regional field offices prioritize which licensed retail marijuana stores to inspect, (2) for addressing complaints received from consumers related to retail marijuana, (3) for ensuring compliance with state requirements by retail marijuana businesses and taking associated enforcement actions when appropriate, and (4) for procurement of a seed-to-sale marijuana inventory tracking system contract, as required by statute. We focused our audit work on retail marijuana activities that occurred from July 2018 through June 2022, or Fiscal Years 2019 through 2022. The work we performed related to complaints found that the Division’s process for addressing complaints, including reports of adverse health events, is functioning effectively, and we do not have any recommendations for improvement in this area. However, as discussed in this chapter, we identified opportunities for the Division to improve its processes related to prioritizing inspections of retail marijuana businesses, taking enforcement actions to ensure compliance when violations are identified during inspections, and procuring a seed-to-sale inventory tracking system.

Finding 1—Prioritization of Retail Store Inspections

Senior management and investigators employed by the Division have the authority to investigate suspected violations of marijuana laws and rules, as well as to inspect, examine, or investigate any premises where regulated marijuana is grown, stored, cultivated, manufactured, tested, distributed, or sold [1 CCR 212-3, Rule 8-105(B)]. Inspections of retail marijuana stores are a vital component of the “Division’s commitment to the fair, impartial, stringent, and comprehensive administration” of the Colorado Marijuana Code and are intended to improve compliance among marijuana businesses [Division Policy, MED-F12]. To fulfill its regulatory responsibilities, the Division conducts targeted compliance inspections of retail marijuana stores, which can include inspecting specific components of a licensed store’s premises such as observing its employees, reviewing its security cameras and logs, and reviewing its marijuana product inventory. Inspections are handled by investigators in the Division’s four geographic enforcement regions: Denver, Longmont, Colorado Springs, and Grand Junction.

According to the Division, investigators can conduct some inspection activities remotely, without the need for an investigator to physically visit a business’s licensed premises, such as reviewing

marijuana inventory and product testing records in the Marijuana Enforcement Tracking Reporting Compliance (METRC) system, the Division's seed-to-sale marijuana inventory tracking system. State marijuana rules require licensed marijuana businesses to enter accurate information in METRC about their inventory of all marijuana products in the regulated market from seed (when a marijuana plant begins the cultivation process) to the point the marijuana is sold to the consumer. The Division indicates that it can identify potential violations and noncompliance through careful monitoring of a business's records in METRC.

However, many inspections usually necessitate a site visit by an investigator. According to Division investigators, beyond physically inspecting a business's licensed premises to ensure compliance with statute and regulation, site visits also allow the Division to engage with business owners and employees to provide guidance and education and establish trust with the industry. Division management stated that proactive engagement and communication with licensed businesses is critical for oversight of the evolving regulated marijuana industry and public safety. One common type of inspection the Division conducts at retail marijuana stores is underage compliance checks, which involve operatives between the ages of 18 and 20.5 years of age attempting to buy marijuana from a licensed retail store. These inspections allow the Division to test a business's compliance with requirements intended to prevent unlawful sales of marijuana to minors.

To support investigators in identifying businesses to inspect, the Division has developed a risk-based inspection system. According to Division management, enforcement region supervisors and investigators consider several factors when determining which licensed businesses should undergo an on-site inspection, including the Division's previous interactions and inspections of a business; information related to a business received from local agencies, including law enforcement; and a review of the licensee's information in METRC.

In addition, staff in the Division's Data Analysis Unit generate monthly and ad hoc reports from data in the Department of Revenue's (Department) My License Office (MyLO) database and METRC. These reports include a monthly underage compliance check report and a monthly targeted inspection report—both of which contain fields with basic information about licensed marijuana businesses, such as the license number and business name, plus additional fields intended to tell investigators about the business's relevant inspection history. The Data Analysis Unit generates the monthly reports based on specific criteria to narrow the list of businesses that appear on the reports based on risk. For the monthly targeted inspection report, a retail marijuana store appears on the report if it has not undergone a targeted inspection within the previous 2 years or if it has never been inspected. For the underage compliance check report, a retail marijuana store appears on the report if it:

- Has never had an underage compliance check;
- Has not had an underage compliance check within a Division-established time frame that the Division adjusted for compliance targets, ranging between 9 months and 24 months; or

- Failed a previous underage compliance check, meaning that the store illegally sold retail marijuana to an operative working for the Division who was under 21 years old or otherwise violated the underage marijuana regulations.

According to the Division, the queries used to generate these monthly reports are intentionally broad, and it is not expected that investigators will conduct an inspection of every business listed on the reports. Rather, both reports are tools to assist investigators with the prioritization of retail marijuana businesses that should be inspected based on inspection and violation history. Division management explained that the Division leverages multiple sources of data to inform investigation activities, and the monthly reports are a part of these efforts.

What was the purpose of the audit work and what work was performed?

The purpose of the audit work was to assess the effectiveness of the Division's prioritization of inspection processes, including its use of monthly targeted inspection and underage compliance check reports to help the Division prioritize its inspections of licensed retail marijuana stores based on risk.

To understand how the Division prioritizes its inspections and how it uses the monthly targeted inspection and underage compliance check reports, we reviewed statutes, rules, the Division's Policies and Procedures Manual, the Division's training resource guides, and other internal guidance related to prioritizing inspections. We also interviewed Division management and staff, including agents in charge of the Division's enforcement regions, field investigators, and staff who analyze MyLO and METRC data to generate reports listing retail marijuana stores that should be considered for inspections. We conducted site visits to the Division's four enforcement regions, where we observed inspections of retail marijuana stores to gain an understanding of how the Division prioritizes which stores should undergo inspections and what the inspections cover. This included observing several underage compliance checks in the Denver enforcement region that occurred in 2022.

In addition, we performed aggregate analysis of the Division's business inspection data in MyLO for Fiscal Years 2019 through 2022. Our work included analyzing trends in the number of underage compliance checks and in-person inspections that the Division conducted prior to, during, and after the COVID-19 pandemic. For purposes of our analysis, we focused on underage compliance checks and the 11 inspection types that the Division reported are typically conducted in person (e.g., compliance field inspections, inspections related to a licensee's possible diversion of marijuana to the black market, inspections related to concerns about waste disposal); the data showed that the Division conducted 1,352 targeted inspections and 1,239 underage compliance checks during this 4-year period. We also performed aggregate analyses of the monthly underage compliance check and targeted inspection reports that Division staff generated for Fiscal Years 2019 through 2022 for

investigators' use in prioritizing inspections in line with the Division's risk-based inspection system. We reviewed these data to assess if the targeted inspection and underage compliance check reports were utilized by investigators when prioritizing the inspection of businesses, and if the businesses that were inspected aligned with the Division's risk-based prioritization system.

How were the results of the audit work measured?

Division policy establishes a risk-based inspection system to help the Division target its limited investigative resources on new and existing retail marijuana businesses that are most likely to be noncompliant with marijuana laws and regulations [Division Policy, MED-F11]. This risk-based inspection system is based on the following risk factors.

New Business Inspections. Division policy states:

- The Division will strive to inspect all newly licensed businesses within 1 year of those businesses receiving their license from the Division [Division Policy, MED-F11].
- Businesses that are deemed high-risk will be inspected within 120 days of the date the state license is issued [Division Policy, MED-F11]. Newly licensed marijuana businesses are considered high-risk if the business, owners, or employees are undergoing criminal investigations related to the regulated marijuana industry, if the business owner has a history of compliance problems associated with other marijuana businesses, or if the business or owners have been the subject of a credible complaint. If a new business that was deemed to be high-risk has not yet begun operations, an investigator may need to wait to conduct the inspection so that it occurs within 60 days after the business begins operating [Division Policy, MED-F11]. According to Division policy, supervisory investigators in each region should check licensing information in the MyLO database and other licensing documents for each new business to determine if any circumstances exist that would deem the business high-risk.

Existing Business Inspections. Division policy directs investigators to prioritize targeted inspections of businesses that are most likely to be noncompliant with Colorado marijuana laws and regulations, but also allows supervisory investigators the discretion to consider factors, such as requests from local jurisdictions or a past history of noncompliance, when prioritizing inspections and determining which businesses to inspect [Division Policy, MED-F12]. In addition, Division policy directs investigators to prioritize targeted inspections of existing retail marijuana businesses based on the following risk factors [Division Policy, MED-F11 and F12]:

- If there are known active criminal investigations or criminal charges against a business, its owners, or its employees, related to the business.
- Receipt by the Division of a complaint against a business.

- If the business has failed to maintain compliant use of METRC.
- If the business or the owner has a history of compliance problems in the previous 12 months.

The monthly targeted inspection reports prepared by the Division's Data Analysis Unit are generated from a centralized data repository that uses data from METRC and MyLO.

Underage Compliance Checks. Division policy requires investigators to prioritize inspection of potential violations affecting public safety, which include sales or distribution of retail marijuana to individuals under age 21 [Division Policy, MED-F12, Section A(1) and 1 CCR 212-3, Rule 6-110]. According to Division policy, underage compliance checks can be conducted under the following, non-exhaustive list of circumstances [Division Policy, MED-F17]:

- When the Division has received a complaint against a licensee for alleged sale of marijuana to underage persons;
- At the request of the local law enforcement agency or local licensing authority; or
- As part of an ongoing compliance program.

Some of the businesses appear on the monthly reports because they have previously failed an underage compliance check. In that circumstance, a business will continue to appear on subsequent reports until the business has achieved two compliant underage compliance checks after their initial failure. In practice, this means that investigators will need to perform at least two subsequent checks of that business and attempt to obtain a compliant result before the business will no longer be listed on the report for a previously failed check.

What issues did the audit work identify and why did they occur?

Overall, we found the Division is conducting targeted inspections and underage compliance checks of retail marijuana stores throughout the state in its effort to inspect stores that are likely to be noncompliant with marijuana laws and regulations. Exhibit 2.1 shows the total number of each type of inspection that the Division conducted for Fiscal Years 2019 through 2023.

Exhibit 2.1

Targeted Inspections and Underage Compliance Checks, Fiscal Years 2019 – 2023¹



Source: Office of the State Auditor analysis of Division data for Fiscal Years 2019 through 2022.

¹ Data for Fiscal Year 2023 was reported by the Division and reflects inspections conducted from July 1, 2022 through June 28, 2023.

In Fiscal Year 2020, the number of targeted inspections and underage compliance checks declined with the start of the COVID-19 pandemic. The Division reported that, beginning in March 2020, the pandemic had a significant impact on its ability to conduct targeted inspections and underage compliance checks because of concerns about the health and safety of investigators and underage operatives. In lieu of underage compliance checks, the Division reports that it conducted more targeted inspections or found alternative ways to evaluate how retail marijuana stores verified the age of consumers, such as by watching security camera footage. Our analysis confirmed that the Division did not conduct any underage compliance checks between April 2020 and February 2021. The Division also stated that even as pandemic restrictions began to ease, they struggled to hire underage operatives, which continued to hinder their ability to conduct underage compliance checks. The data shows that post-pandemic, the Division has increased its overall in-person inspections each year from Fiscal Year 2021 to Fiscal Year 2023, but targeted inspections and underage compliance checks have not yet returned to pre-pandemic inspection levels.

In our review of targeted inspections and underage compliance checks, we analyzed the Division's risk-based prioritization of inspections and found that the Division was not always inspecting the stores according to risk, as outlined in its policies, during the timeframe we reviewed. Between Fiscal Years 2019 and 2022, one in five (20 percent) of the licensed retail marijuana stores in the state did not undergo one of the 11 targeted inspection types typically conducted in person, and the stores that were inspected did not always meet the prioritization factors listed in policy. We identified five areas where the Division could improve its prioritization of the targeted and underage inspection processes to ensure that stores that are being inspected are those that are more likely to be noncompliant.

1. The Division did not inspect all stores within 1 year of licensure.

We found that during Fiscal Years 2019 through 2022, the Division did not inspect 36 percent of newly licensed retail marijuana stores (40 out of 112 newly licensed stores) within 1 year of approving those licenses. Although Division policy indicates that the Division “will strive to inspect all newly licensed premises within one year from the date the state license is issued,” Division management told us that they would not necessarily have expected all newly licensed retail marijuana stores to undergo inspections during their first year of licensure by the Division. According to the Division, some stores encounter delays obtaining licenses from the local jurisdictions where the stores are located, or the stores might not begin making sales within the first 12 months of licensure. Statute requires marijuana businesses to obtain licenses from both the Division and relevant local jurisdiction before beginning any operations [Section 44-10-313(2)(b), C.R.S.]. However, the Division’s monthly targeted inspection reports do not include information on when stores became operational. Investigators have to research each individual store to determine when they were licensed and began operating. This can be time-consuming for the regions that have more licensed retail marijuana businesses. For example, a monthly targeted inspection report for one region contained almost 900 businesses, while the monthly report for another region listed fewer than 30 businesses. To make the reports more useful for investigators, the Division should explore ways to query MyLO and METRC for licensing and sales information and include this information in the monthly reports provided to the regions.

2. The Division cannot identify high-risk businesses on an aggregate level.

We also attempted to determine if the Division investigated newly licensed or existing retail marijuana stores that fit the high-risk criteria outlined in policy. However, the targeted inspection reports do not include the information needed to assess new or existing stores against the high-risk criteria. This is because MyLO and METRC do not contain data fields that capture the high-risk indicators specified in policy. For example, MyLO does not have fields that indicate if a business or its owners or employees are the subject of known active criminal investigations or charges. Instead, Division staff told us that they primarily document information about their investigative activities in a separate case tracking spreadsheet outside of MyLO that cannot be queried. As a result, this information is not included in the targeted inspection reports and there was no way to verify if the Division prioritized stores for inspection in accordance with its risk-based inspection system.

Therefore, MyLO data could not be used to analyze targeted inspection reports at an aggregate level to determine which businesses were considered high-risk and should have been inspected within 120 days of being approved for licensure or otherwise prioritized. Instead, Division staff have to research individual records in MyLO and METRC for each retail marijuana store to determine if any of the risk factors apply to the store. Further, many data points about a business’s history cannot be easily queried in MyLO because that information is documented in narrative fields, attachments,

“... MyLO data could not be used to analyze targeted inspection reports at an aggregate level to determine which businesses were considered high-risk and should have been inspected within 120 days of being approved for licensure...”

or other open text fields. In addition, the MyLO investigations module does not contain data on complaints the Division has received and specific enforcement actions taken against licensed businesses, which could also be used to inform the monthly reports. In order for the monthly reports to include aggregate data on which stores should be considered high-risk, the Division would need to find a way to capture information related to the risk factors in data fields in MyLO that can be queried on an aggregate level for all businesses.

3. The Division did not conduct targeted inspections on some businesses that met risk factors.

We analyzed whether the Division conducted any of the 11 types of in-person inspections of retail marijuana stores that appeared on the Division's monthly targeted inspection reports because they had never undergone an inspection or had not been inspected within the previous 2 years. We found that between Fiscal Years 2019 and 2022, the Division did not inspect 182 of the 567 licensed retail marijuana stores (32 percent) that appeared on at least one monthly targeted inspection report. Of those 182 stores, 75 stores appeared in a monthly report because the Division had not conducted a targeted inspection of them previously. While these 75 stores had never been inspected, the Division inspected other stores multiple times during this time period. For example, we found that the Division inspected one store 19 times during that 4-year period. We could not determine if the Division inspected these stores multiple times because they were considered higher risk than the stores that were not inspected due to a lack of data available on the Division's risk assessment for these businesses.

4. The Division did not perform underage compliance checks on some businesses that met risk factors.

Retail marijuana stores appeared on the Division's monthly underage compliance check reports because the stores satisfied one of the three risk factors that the Division uses to generate the reports, as noted previously. However, the Division did not prioritize conducting underage compliance checks for the stores listed on the monthly reports. Specifically, we found that the Division did not conduct an underage compliance check for:

- 64 of the 190 (34 percent) retail marijuana stores that appeared on a report because the Division had never completed an underage compliance check for that business.
- 200 of the 561 (36 percent) retail marijuana stores that appeared on a report because the Division had not completed an underage compliance check within a Division-established time frame—ranging between 9 months to 24 months.
- For the 67 stores that appeared on a report because they had failed a previous underage compliance check, the Division did not conduct any follow-up checks for 16 (24 percent) of the stores and only one follow-up check for 28 (42 percent) stores. Only 23 (34 percent) stores had at least two follow-up sales checks, as required.

The Division completed at least one underage compliance check for 554 of the 629 (88 percent) retail marijuana stores after the stores appeared on at least one monthly underage compliance check report during the period reviewed; this means that 75 of the stores included on a report did not undergo an underage compliance check after they appeared on a report. According to the Division, 19 of these stores may not have undergone an underage compliance check because they received their license during the COVID-19 pandemic, which impacted the Division's ability to conduct these checks. However, it is not clear why the remaining 56 stores were not inspected, especially when the Division conducted multiple underage compliance checks at some retail marijuana stores during this time period, even though these stores did not have a history of illegal marijuana sales to underage operatives. For example, the Division conducted seven underage compliance checks at 1 store; another 9 stores were subject to six underage compliance checks each; and 36 stores each had five underage compliance checks conducted, even though none of these stores had a history of a noncompliant underage compliance checks. Further, when we reviewed Division data for the 54 businesses that had undergone at least five different underage compliance checks during this time period, only 8 of those businesses (about 15 percent) had a history of having previously sold retail marijuana to underage operatives. While the underage compliance check reports do contain a field indicating if a store has failed a prior underage compliance check, the reports do not indicate the date of the failed inspection. The reports only indicate the date of the most recent inspection, regardless of the outcome.

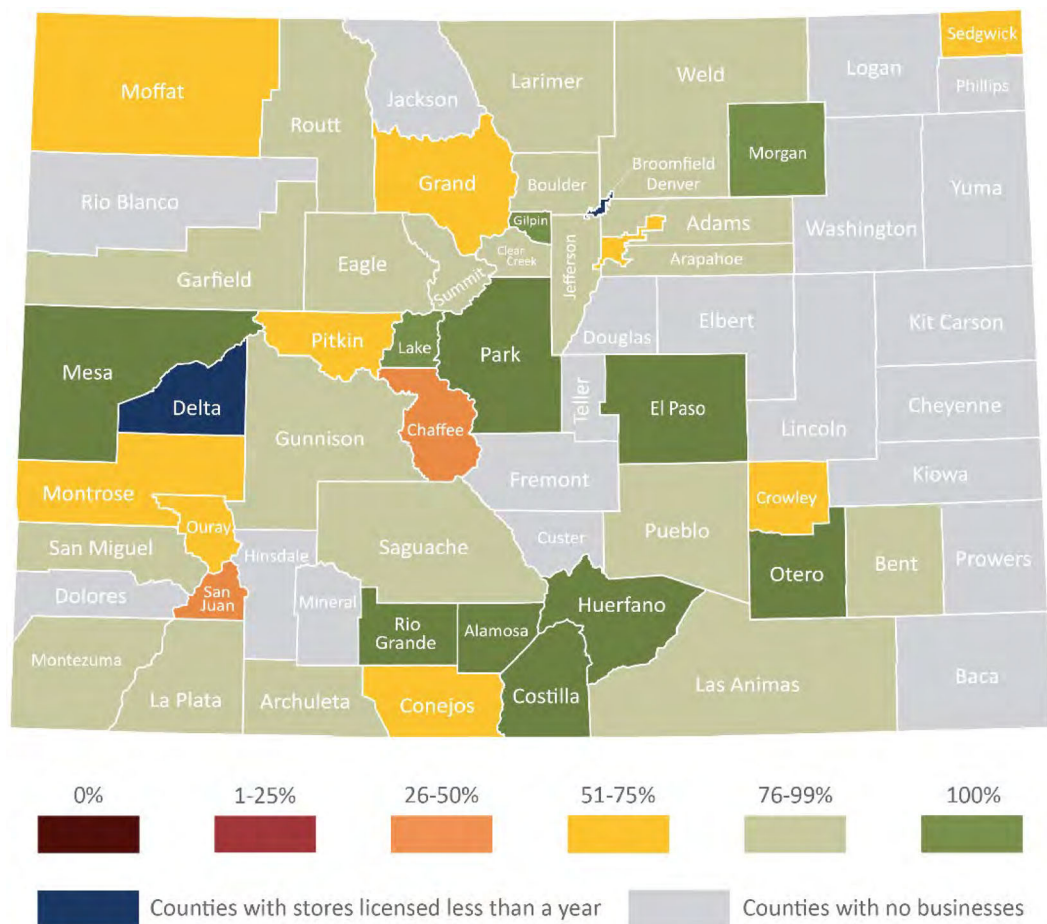
5. The Division did not provide guidance to investigators on how to weigh all risk factors when considering which stores to inspect.

We found that the Division has not provided sufficient guidance to staff on how to weigh the various risk factors for a business when deciding which retail marijuana stores to inspect. During our site visits to the Division's four regional offices, investigators told us that while they consult the monthly reports when deciding which retail marijuana stores to inspect, they also consider other factors, some of which are listed in policy, while others are not. Investigators stated that they will consider the high-risk criteria listed in policy, the Division's goals, regional priorities, a business's history of compliance, or other extenuating circumstances.

In addition, investigators told us they have to consider other factors not related to risk, such as an underage operative's availability and regional geography, when planning investigations. For example, some regional staff told us that they might plan inspections for a group of stores that are situated in close proximity to each other regardless of whether the businesses have any of the risk factors listed in policy, or they might be restricted in conducting underage compliance checks due to their underage operatives' location and availability. In addition, regional staff told us that their inspections may be prompted by businesses contacting them directly about compliance questions or concerns and, as a result, investigators may visit those businesses more frequently than others. Investigators also stated that it is difficult to conduct inspections for stores that are located long distances from their regional office because of the significant travel time involved, which can affect their ability to prioritize those stores.

We examined the percentage of stores in each county that underwent a targeted inspection or underage compliance check at any time during Fiscal Years 2019 through 2022. As shown in Exhibits 2.2 and 2.3, we found that the 42 counties that have licensed retail marijuana stores varied in their percentages of stores that received a targeted inspection or underage compliance check. For example, as shown in Exhibit 2.2, Division investigators conducted targeted inspections for only 40 percent of the retail marijuana stores in Chaffee County during this 4-year period, but inspected all of the stores in Mesa County.

Exhibit 2.2
Targeted Inspections Conducted Out of All Operational Retail Marijuana Stores
Fiscal Years 2019-2022

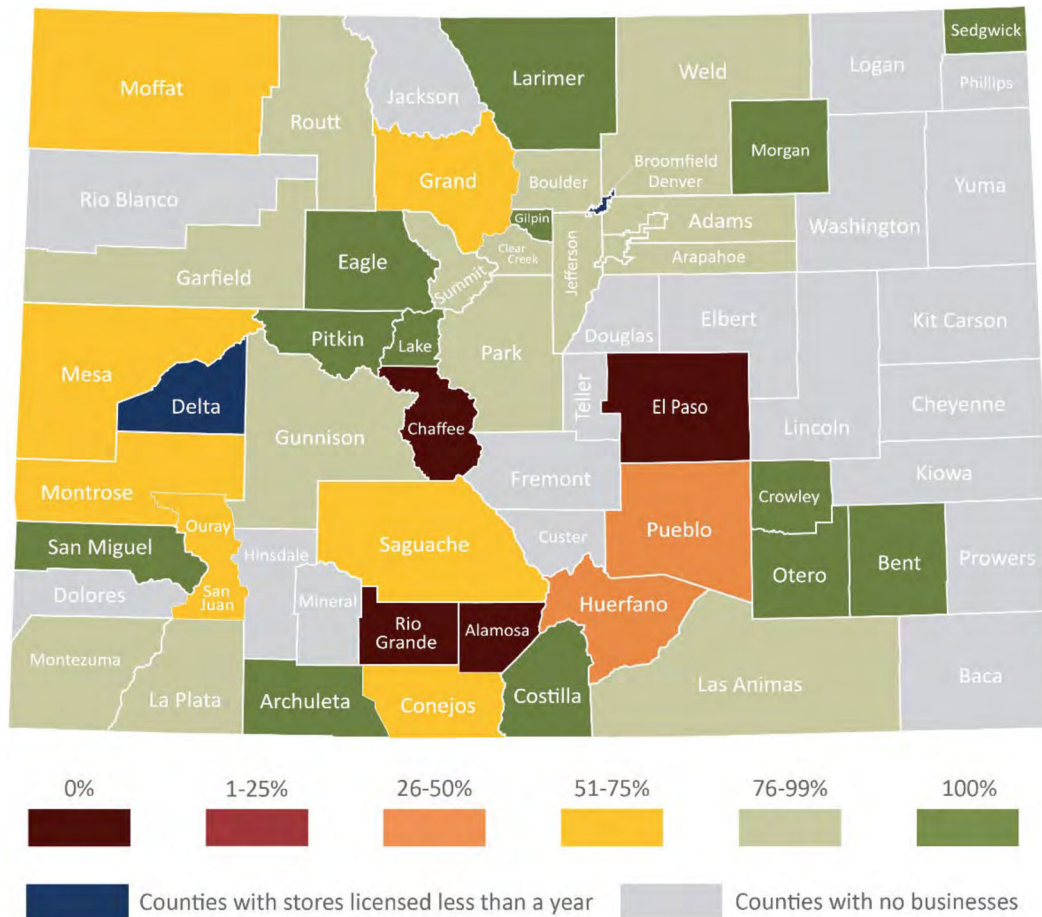


Source: Office of the State Auditor analysis of Division data.

Underage compliance checks also showed the same variance among counties. For example, as shown in Exhibit 2.3, Division investigators did not perform underage compliance checks at any store in Chaffee County during the 4-year period, but they conducted an underage compliance check for every retail marijuana store in Larimer County. This leads to an unequal frequency of inspections of stores both within a specific county or region, and on a statewide level.

Exhibit 2.3

Underage Compliance Checks Conducted Out of All Operational Retail Marijuana Stores Fiscal Years 2019-2022



Source: Office of the State Auditor analysis of Division data.

Why do these issues matter?

It is important that the Division provide sufficient tools and information to its investigative staff so that they can efficiently prioritize inspections of retail marijuana stores by risk. This will help ensure that the Division can effectively fulfill its mission “to promote public safety and reduce public harm by regulating the Colorado commercial marijuana industry through consistent administration of laws, [and] regulations.” For example, as noted previously, during Fiscal Years 2019 through 2022, one in five (20 percent) of the licensed retail marijuana stores in the state did not undergo one of the 11 targeted inspection types typically conducted in person. Since the Division does not track data on the high-risk factors that indicate if a business is at a greater risk for noncompliance with marijuana laws and rules, some of those 20 percent of businesses that were not inspected could have been at a

“...some of those 20 percent of businesses that were not inspected could have been at a higher risk of violating Colorado marijuana laws and possibly endangering public health and safety than those that underwent inspections.”

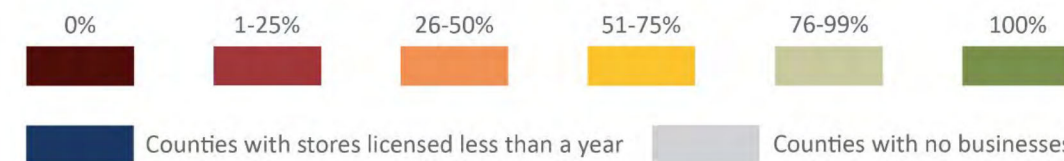
higher risk of violating Colorado marijuana laws and possibly endangering public health and safety than those that underwent inspections.

In addition, if the Division does not follow its established risk-based system, it could create a

perception that the Division is not regulating Colorado’s retail marijuana industry consistently across the state, which could erode public trust in the Division and the industry. Further, if the Division conducts repeated inspections of a business that does not have a history of noncompliance, or allows businesses with a history of noncompliance to operate without inspection, those inequities could lead to a belief that the Division is unfairly targeting some businesses while favoring others. For example, when we spoke to staff at retail marijuana stores during our inspection observations, they reported that recommendations made by the Division during inspections can result in businesses having to spend money on items such as cameras, signage, or training in order to come into compliance with requirements. Other stores that were not inspected at all during our review period would not have had the same burden of spending resources to come into compliance.

We compared the proportion of licensed retail marijuana stores that underwent a targeted inspection or underage compliance check in each county after appearing on a monthly report and found disparities, as shown in Exhibits 2.4 and 2.5. For example, while investigators in Moffat County performed targeted inspections on 100 percent of the businesses listed on their monthly reports, Bent County did not perform targeted inspections of any stores listed on their monthly reports.

Percentage of Targeted Inspections Conducted of Retail Marijuana Stores Listed on Targeted Inspection Reports¹, Fiscal Years 2019-2022

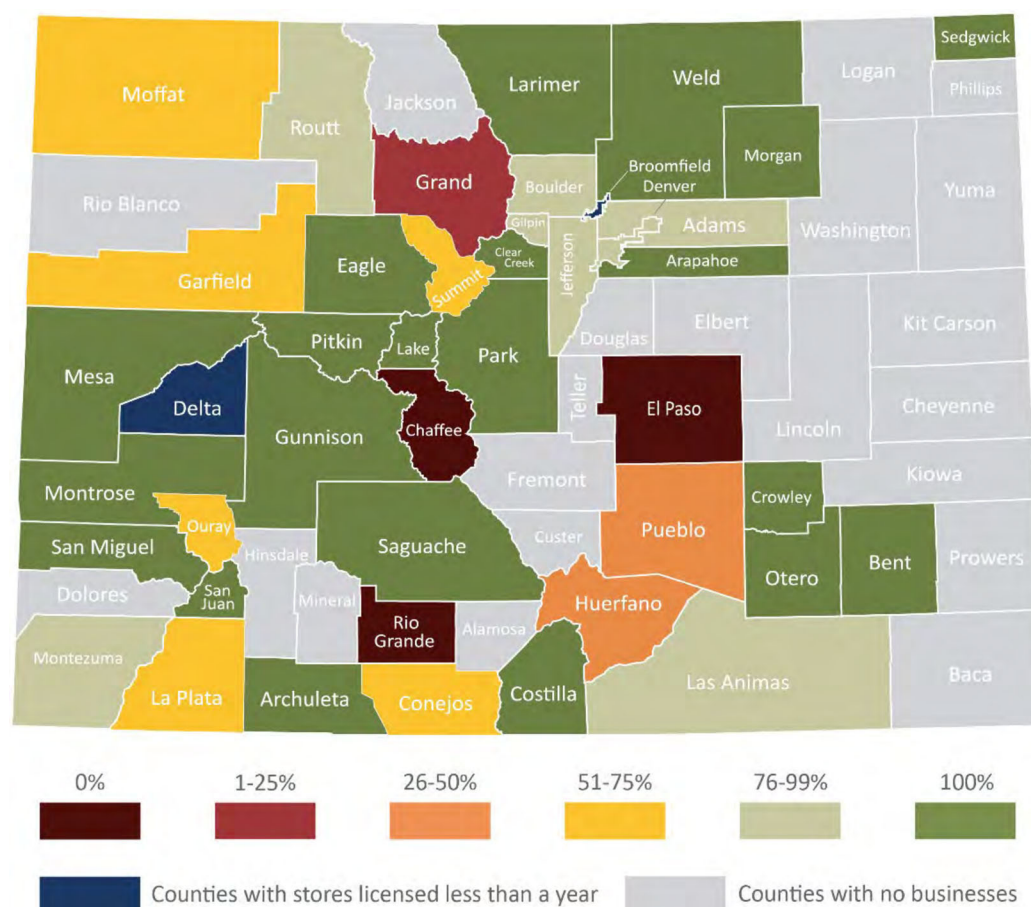


¹ Ouray County had four licensed retail marijuana stores during Fiscal Years 2019 through 2022, but those stores never appeared on a Targeted Inspection Report during those years.

As shown in Exhibit 2.5, for underage compliance checks, investigators in Eagle County performed at least one underage compliance check on 100 percent of the retail marijuana stores that appeared in at least one monthly underage compliance check report, while investigators in El Paso County did not perform a check on any of the stores that appeared in their monthly report.

Exhibit 2.5

Percentage of Underage Compliance Checks Conducted of Retail Marijuana Stores Listed in Underage Compliance Check Reports¹, Fiscal Years 2019-2022



Source: Office of the State Auditor analysis of Division data.

¹ Alamosa County had one licensed retail marijuana store during Fiscal Years 2019 through 2022, but that store never appeared on an Underage Compliance Check Report during those years.

Finally, when the Division does not complete underage compliance checks, there is an increased risk that marijuana could be sold to minors. While preventing retail store sales to minors does not eliminate all potential avenues of youth access to marijuana, the Division’s underage compliance checks serve as an integral form of deterrence because they assess a business’s compliance with laws and rules that are intended to make sure only customers over age 21 are buying marijuana from these stores. According to Division investigators, by conducting an underage compliance check, the Division is able to functionally test a business’s knowledge of legal and regulatory requirements associated with marijuana sales, the practical application of a business’s standard operating procedures, and training provided to a business’s employees.

Recommendation 1

The Marijuana Enforcement Division (Division) should improve its retail marijuana store inspections process and ensure that it effectively prioritizes stores for on-site inspections based on risk. This should include:

- A. Modifying the targeted inspection reports to include information on which newly licensed stores are operational, and modifying the targeted inspection and underage compliance check reports to include data on risk factors that indicate if a store should be considered high-risk.
- B. Developing and implementing a policy and procedure for regional offices on (i) how to utilize monthly targeted inspections and underage compliance check reports to prioritize inspections and (ii) how investigators should take into account all the risk factors and time requirements when deciding which businesses are a priority.

Response

Marijuana Enforcement Division

- A. Agree

Implementation Date: July 2024

The Marijuana Enforcement Division (Division) prioritizes youth access prevention and public health/safety via a range of measures, including underage compliance checks, investigating advertising, packaging, labeling, and testing compliance, and responding to adverse health event reports.

The Division's strategies include identification of best practices through education and collaborative engagement with licensees, agency partners (at the state, local, and federal level) and other stakeholders. These efforts also facilitate data collection to track trends, prioritize deployment of investigative resources, and public reporting. The recommendation can further enhance how the Division efficiently identifies stores for prioritized inspections. The Division will work with its data analytics team (and system vendors, as necessary) to incorporate more detail on the operational status of stores, risk factors, and which stores are considered high risk for noncompliance in its reports.

Regarding the Office of the State Auditor's (OSA's) statements that the Division did not inspect retail stores in a specified period, the Division wants to clarify that this does not mean the Division never inspected or investigated the store as part of another compliance matter (inspection categories not within the scope of the OSA's review) during that same period.

The Division also understands the OSA’s audit included review of the Division’s complaint processes, which include those related to adverse health event reports, and the OSA determined the Division’s processes in these areas are “functioning effectively.”

B. Agree

Implementation Date: July 2024

The Division agrees the recommendation can improve how investigators utilize tools to prioritize investigations. To implement the recommendation, the Division will work with regional offices to update and establish new policies, as well as other guidance and training resources focused on evaluation of risk factors, how to prioritize inspections, and how to more effectively utilize the monthly reports.

Further, regarding OSA’s mention of multiple underage checks at stores previously checked, an example of why this would occur is due to the close proximity to other licensees that provided the opportunity for the Division to further verify compliance and engage with licensees. However, the Division recognizes the value of improving its processes for documenting the bases for these approaches.

The Division has over several years improved its trainings and deployment of investigative resources by:

- Involving teams to contribute to the development of training resource guides
- Distributing final agency actions to all supervisory investigators for awareness of factors relied upon to reach a disposition
- Higher frequency of meetings between regional teams to discuss timely issues and trends and to support consistent approaches to the Division’s investigative work.

Colorado’s cannabis framework continues to evolve in a manner that will require regular evaluation of risk factors (for example, the Division’s approach to underage compliance checks needs to also account for home delivery transactions, where the transfer of marijuana occurs at a private residence). The Division is committed to providing staff with appropriate training and guidance, and working with stakeholders to ensure transparency and facilitate a culture of compliance.

Finding 2—Enforcement of Marijuana Laws and Rules

The State Licensing Authority (i.e., the Executive Director of the Department of Revenue) is responsible for enforcing Colorado’s marijuana laws and rules promulgated for the proper regulation and control of the cultivation, manufacture, distribution, sale, and testing of regulated marijuana and regulated marijuana products [Sections 44-10-201(1) and 44-10-202(1)(c), C.R.S.]. The State Licensing Authority has delegated day-to-day enforcement activities to the Division, which employs staff to investigate violations or suspected violations of marijuana laws and rules [1 CCR 212-3, Rule 8-105(A)]. Division investigators have all of the powers of any peace officer to inspect, examine, or investigate any premises where a licensee’s regulated marijuana is grown, stored, cultivated, manufactured, tested, distributed, or sold, including any books and records connected with any licensed or unlicensed activity [1 CCR 212-3, Rule 8-105(B)].

Division staff investigate licensed retail marijuana businesses to determine whether they are complying with applicable marijuana laws and rules, either in a single operational area or across an entire business operation. Investigative activities can include inspections of the retail marijuana store’s premises; observations of operational activities (e.g., marijuana sales at the point of sale); interviews with store owners and employees; and/or a review of the business’ marijuana inventory records in METRC, the Division’s marijuana inventory tracking system.

If a Division investigator finds evidence that a licensed marijuana business or individuals holding occupational licenses (e.g., owners, managers, and employees of the licensed business) have violated laws and/or rules, the investigator can pursue multiple disciplinary actions for each violation. The Division investigator can issue a verbal or written warning to notify the business or individual about a violation. The Division may also issue Assurances of Voluntary Compliance, which do not constitute disciplinary action, but rather are written agreements in which licensees agree to comply with marijuana laws and rules in the future [1 CCR 212-3, Rule 8-120]. Investigators can also recommend disciplinary action, such as requiring store employees to undergo training, assessing a monetary penalty, or taking action against the business or occupational licenses (e.g., suspension, revocation) [Section 44-10-901(1), C.R.S.]. If the Division decides disciplinary action may be warranted, legal staff in the Division’s Analysis and Resolution Team work with Division investigators, the Office of the Attorney General, and the State Licensing Authority to pursue such action. The Division often resolves disciplinary actions through written agreements (called Stipulation, Agreement and Orders) that are signed by the Division’s Senior Director, the State Licensing Authority, and a representative of the licensee who is subject to the disciplinary action.

Information about Division investigations and resulting enforcement actions is documented in the Department’s MyLO database. Documentation can include notes fields populated with details about investigative activities that were performed, alleged violation(s) identified, and any disciplinary action that the investigator and their supervisor collaboratively recommended. Reports of Investigation summarize the results of the investigation and are signed by the investigator and Division

management. When applicable, legal agreements specify disciplinary action that was taken in response to violations identified during the investigation. The Division's Analysis and Resolution Team also maintains a tracking spreadsheet that includes details about the team's work on investigations that identified violations and resulted in the Division recommending disciplinary action.

What audit work was performed, what was the purpose, and how were the results of the audit work measured?

We reviewed state laws, rules, and Division policies related to retail marijuana business investigations and disciplinary actions that can be taken when violations of marijuana rules and laws are identified during the investigations. We also interviewed Division management and staff; conducted site visits at the Division's four regional offices, which included interviews with staff and observations of retail marijuana business investigations; and observed underage compliance checks. In addition, we analyzed aggregate data related to investigations of retail marijuana stores that the Division conducted from July 2018 through June 2022. This included MyLO data on 375 investigations that the Division conducted of alleged violations. We also selected a random sample of 20 Division investigations that occurred from August 2021 to June 2022 and resulted in Division investigators identifying evidence of 44 alleged violations of marijuana laws and rules; 7 of the 20 investigations were underage compliance checks. For each investigation in our sample, we reviewed documentation in the MyLO record and the Analysis and Resolution Team's tracking spreadsheet to assess whether the Division pursued disciplinary action that aligned with the severity of marijuana law or rule violations that investigators found evidence of during their investigations, as well as how consistently the Division enforced similar types of violations.

The purpose of the audit work was to determine whether the Division consistently pursues appropriate enforcement action when Division investigators identify evidence of alleged violations of marijuana laws or rules.

The following requirements apply to the Division's process for enforcing marijuana laws and rules.

Consistent Enforcement. The expectation for consistent enforcement of the marijuana industry was established in Amendment 64, which legalized marijuana for recreational use and states, "It is necessary to ensure consistency and fairness in the application of this section [of the Colorado Constitution] throughout the State" [Colorado Const., Article XVIII, Sec. 16(1)(d)]. Similarly, Division policy states that business investigations "demonstrate the Division's commitment to the fair, impartial, stringent, and comprehensive administration" of marijuana laws and rules [Division Policy, MED-F12]. Further, the Division's mission is "to promote public safety and reduce public harm by regulating the Colorado commercial marijuana industry through *consistent* administration of laws, regulations, and strategic integration of process management, functional expertise, and innovative problem-solving" [emphasis added].

Citations of All Relevant Violations. Division policy states that Division investigators should “note any deficiencies that are found [during investigations of marijuana businesses], and recommend the appropriate administrative actions for any violations of Colorado Marijuana Laws and Regulations” [Division Policy, MED-F12(B)]. The Division uses the term “administrative action” to refer to disciplinary actions against licensees.

One area that Division investigators cover during investigations relates to sales of marijuana to underage individuals. Under state law, it is illegal for a licensed retail marijuana store to sell or permit the sale of marijuana to a person under age 21 [Colorado Const., Art. XVIII, Sec. 16(1)(b)(II) and Section 44-10-701(5)(a), C.R.S.]. Statute and rule also establish requirements for marijuana sales that would be violated if marijuana is sold to an underage individual. Specifically, store employees are required to verify a purchaser’s age by checking that a valid identification card shows the purchaser is age 21 or older; licensed stores are prohibited from permitting a person under age 21 from entering the Restricted Access Area, which is a designated and secure area within a licensed retail marijuana store where retail marijuana is sold, possessed, and displayed for sale; licensed stores may only transfer retail marijuana to consumers who produce a valid form of identification proving that the consumer is age 21 or older [Colorado Const., Art. XVIII, Sec. 16(1)(b)(I); Section 44-10-601(3)(b)(I), C.R.S.; and 1 CCR 212-3, Rules 1-115, 6-110(A), 6-110(B), and 3-405(B)]. The Division works with operatives between 18 and 20.5 years of age to conduct underage compliance checks, which involve an underage operative attempting to buy marijuana from a licensed retail store. These compliance checks help the Division detect and deter illegal marijuana sales to underage individuals. If an underage operative successfully purchases retail marijuana during an underage compliance check, Division investigators are required to document all alleged violations of law and rule that they observe or have evidence of associated with the sale, including those related to the operative’s entry into the store.

Disciplinary Actions. Statute states, “The State Licensing Authority shall impose any penalty authorized by this article 10 [regulated marijuana laws] or any rule promulgated pursuant to” those laws [Section 44-10-202(1)(b), C.R.S.]. According to Department rules, the State Licensing Authority will make determinations regarding the type of penalty to impose based on the severity of the violation [1 CCR 212-3, Rule 8-235(A)]. Exhibit 2.6 summarizes the three categories of violations specified in rule.

Exhibit 2.6

Retail Marijuana Violation Categories

Category	Definition	Examples of Violations ¹	Enforcement Options
License Violations Affecting Public Safety	Violations of this nature are most severe and generally have an immediate or potential negative impact on the health, safety, and welfare of the public at large.	• Not verifying on two separate occasions that a customer is age 21 or older² • Permitting a person under age 21 to enter the Restricted Access Area where retail marijuana is sold² • Selling retail marijuana to persons under age 21 • Making misstatements or omissions in the Inventory Tracking System • Failing to maintain books and records to fully account for all business transactions • Utilizing advertising material that is misleading, deceptive, or false • Failing to provide a tangible educational resource regarding the use of regulated marijuana concentrate³ when completing a sale² • Giving away free retail marijuana to a consumer for any reason³	• Written warning or assurance of voluntary compliance in lieu of recommending that the State Licensing Authority pursue immediate administrative action. Written warnings and assurances of voluntary compliance are not considered disciplinary actions. • License suspension, restrictions, or revocation • A fine per individual violation • A fine in lieu of license suspension of up to \$100,000
License Violation	This category of violation is more severe than a license infraction but generally does not have an immediate or potential negative impact on the health, safety, and welfare of the public at large.	• Advertising and/or marketing violations (other than misleading, deceptive, or false advertising) • Packaging or labeling violations that do not directly impact patient or consumer safety • Failing to keep and maintain adequate business books and records • Minor or clerical errors in the Inventory Tracking System	• Written warning or assurance of voluntary compliance in lieu of recommending that the State Licensing Authority pursue immediate administrative action. Written warnings and assurances of voluntary compliance are not considered disciplinary actions. • License suspension, restrictions, or revocation • A fine per individual violation • A fine in lieu of license suspension of up to \$50,000

License Infractions	This category of violation is the least severe.	• Failure to display required identification badges, including visitor badges • Unauthorized modifications of the licensed premises of a minor nature • Failure to notify the State Licensing Authority of a minor change in ownership	• Verbal warning that explains the violation and instructs the licensee to correct the situation • Written warning or assurance of voluntary compliance in lieu of recommending that the State Licensing Authority pursue immediate administrative action. Written warnings and assurances of voluntary compliance are not considered disciplinary actions. • License suspension or restrictions • A fine per individual violation • A fine in lieu of license suspension of up to \$10,000
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Source: 1 CCR 212-3, Rules 8-120, and 8-235(A) effective January 1, 2020; Division Policy MED-F12.

¹ The violations listed provide examples but are not an exhaustive list of violations categorized in rule.

² Rule states that failure to comply with rules requiring licensed retail marijuana stores to provide tangible educational resources, verify on two occasions that a person is 21 years of age or older, and avoid giving away free marijuana for any reason may constitute license violations affecting public safety [1 CCR 212-3, Rule 6-110(P)].

³ Regulated marijuana concentrate (also called retail marijuana concentrate) is defined as a subset of retail marijuana that is separated from the retail marijuana plant and results in matter with a higher concentration of cannabinoids than naturally occur in the plant [1 CCR 212-3, Rule 1-115].

The State Licensing Authority may take into consideration any mitigating and aggravating circumstances surrounding a violation that could impact the type or severity of penalty imposed. Those factors include prior violations the licensee has admitted to or was found to have engaged in, good faith measures by the licensee to prevent the violation (e.g., proper supervision, regular employee training, standard operating procedures established prior to the Division's investigation and that directly address the conduct for which imposition of a penalty is being considered), and the licensee's past history of success or failure with compliance checks, among others. The circumstances surrounding any penalty imposed will be determined on a case-by-case basis [1 CCR 212-3, Rule 8-235(B) and (C)].

Business Liability for Employee Actions. A licensed retail marijuana store may be held responsible for all actions and omissions of any person the store employs, contracts with, hires, or otherwise retains to perform any act or conduct on the store's behalf or for the store's benefit. Further, a store may be subject to license denial or administrative action, including but not limited to a fine or license suspension or revocation, based on the act and/or omissions of any person the store employs, contracts with, hires, or otherwise retains [1 CCR 212-3, Rule 2-280(E)].

What problems did the audit work identify?

Overall, we found evidence that the Division does not appear to have consistently pursued appropriate enforcement action when Division investigators identified evidence of alleged violations of marijuana laws or rules, as described in the following sections.

Division investigators did not consistently cite retail marijuana stores for all violations associated with marijuana sales to underage individuals. When an underage operative working with the Division successfully enters a retail marijuana store, gains access to the restricted area where marijuana is sold, and purchases marijuana, those actions represent violations of at least four different legal and regulatory requirements. However, we found that the Division did not take consistent enforcement action against stores with alleged violations of marijuana laws and rules related to underage sales, as follows:

- Issues with Sample—Seven of the 20 investigations in our sample were underage compliance checks, and all seven resulted in illegal retail marijuana sales to individuals under age 21. However, our review of the Reports of Investigations in MyLO found that Division investigators did not consistently cite the same violations for each underage sale in our sample. As shown in Exhibit 2.7, investigators cited all seven stores for selling marijuana to the underage operative. However, only six stores were cited for failing to verify the operative’s age, five stores were cited for allowing the operative into the restricted access area, and three were cited for transferring marijuana to a customer without a valid ID. Division documentation did not include sufficient information for us to determine why investigators cited some violations for some of these retail stores.

Exhibit 2.7

Comparison of Violations Cited Against Stores That Sold Retail Marijuana to Underage Operatives

Sampled Underage Compliance Check	Violation 1: Illegal Underage Sale	Violation 2: Failure to Verify Customer’s Age	Violation 3: Allowing a Person Under Age 21 into a Restricted Access Area	Violation 4: Transferring Marijuana to Customer Without a Valid ID
1	•	•	•	•
2	•	•	•	•
3	•	•	•	•
4	•	•	•	
5	•		•	
6	•	•		
7	•	•		

Source: Office of the State Auditor analysis of seven underage compliance checks included in a sample of 20 Division checks that were conducted from August 2021 through June 2022.

- Issues with Aggregate Data—The Division does not track aggregate data on specific violations that investigators identify evidence of during underage compliance checks. Therefore, we could not analyze the extent to which the Division pursued consistent enforcement actions in response to all underage sales that occurred for Fiscal Years 2019 through 2022.

In some instances, the Division did not pursue disciplinary action in response to violations of marijuana laws and rules. Our analysis of the sampled investigations and the Division’s aggregate data found the following:

- Issues with Sample—In response to 26 of the 44 violations (59 percent) that Division investigators identified during the 20 investigations in our sample, the Division issued verbal or written warnings, or took no action. This means the Division did not pursue any disciplinary action against the retail marijuana stores where investigators identified evidence of alleged violations. These included 23 license “violations affecting public safety” (e.g., violations associated with sales of marijuana to underage individuals and inventory tracking), 1 “license violation” (failure to monitor and resolve compliance notifications from the inventory tracking system), and 2 violations that are not categorized in rule (e.g., improper waste disposal). The Division addressed another 18 violations in our sample using several types of disciplinary actions: assessing fines, suspending the retail marijuana store’s license, requiring the store’s employees to complete responsible vendor training, requiring the store to update its Standard Operating Procedures, and requiring stores to retrain staff on how to use identification scanners.
- Issues with Aggregate Data—The Division does not track aggregate data on specific violations that investigators identify evidence of during compliance checks. Therefore, we could not analyze the extent to which the Division pursued consistent enforcement actions in response to violations that Division investigators identified for Fiscal Years 2019 through 2022.

The Division pursued inconsistent disciplinary actions in response to similar types of violations. Our analysis of the sampled investigations and the Division’s aggregate data found the following:

- Issues with Sample—For the 44 violations in our sample, we compared the violations that Division investigators documented to the resulting disciplinary action. As shown in Exhibit 2.8, we found that the Division took different types of disciplinary actions for similar types of violations, including the two most prevalent types of violations—retail marijuana sales to underage individuals and inventory tracking issues. For 40 of the 44 (91 percent) violations in our sample, Division documentation did not include sufficient information for us to determine the investigators’ or the Division’s reasons for pursuing these different disciplinary actions. Documentation for the remaining four violations did include some insight into mitigating and aggravating circumstances to help explain the Division’s approach. For example, investigators considered a business that was cited for unsanitary conditions to have mitigating and aggravating circumstances because business personnel could not reach the upper portion of the room to clean without a taller ladder. The Division pursued a Stipulation and Agreement Order and suspension of license, and the business obtained a taller ladder.

Exhibit 2.8**Disciplinary Actions in Response to 44 Sampled Violations of Marijuana Laws and Rules**

Topic of Violations	Type of Disciplinary Action Taken				
	No Disciplinary Action ¹	Responsible Vendor Training ²	Update Standard Operating Procedures	Retraining on Identification Scanners	License Suspension
Violations Affecting Public Safety (Most Severe)					
Underage Sale ³	6	15	11	15	9
Inventory Tracking – Public Safety	9	-	-	-	3
Business Records	1	-	-	-	-
Educational Resources	5	-	-	-	-
Free Product	1	-	-	-	-
Signage and Advertising	1	-	-	-	-
License Violations (Moderately Severe)					
Inventory Tracking – License Violation	1	-	-	-	-
Violations Not Categorized in Rule					
Waste Disposal	1	-	-	-	-
Employer Liability for Employee Actions	1	-	-	-	-
Totals⁴	26	15	11	15	12

Source: Office of the State Auditor analysis of 44 violations identified in a sample of 20 Division investigations that were conducted from August 2021 through June 2022.

¹ In these instances, Division investigators issued verbal or written warnings to licensees to notify them about evidence of violations that the investigators identified during their investigations. Verbal and written warnings do not result in disciplinary action.

² For a licensed marijuana business to be designated as a “responsible vendor,” all owners with day-to-day operational control of a licensed marijuana business, management personnel, and employees involved in the handling and transfer of regulated marijuana must attend and successfully complete an approved training program.

³ Our sample included 21 violations involving sales of retail marijuana to underage individuals, which occurred during seven underage compliance checks that were included in our sample.

⁴ The total shown in this exhibit exceeds 44 violations because, in some cases, the Division pursued multiple disciplinary actions in response to a violation.

For the seven investigations in our sample that found violations related to retail marijuana sales to individuals under age 21, we compared disciplinary actions taken against the licensed retail marijuana stores and licensed employees involved with the sales. We found that the State Licensing Authority did not pursue consistent disciplinary action against both the store and their employees involved with the underage sales. For example, in one instance the store employee involved with the underage sale received a criminal summons, but the Division did not take disciplinary action against the store. In another instance, the store employee received a criminal summons and the store was also subject to four types of disciplinary actions. The

Division assessed different monetary penalties ranging from \$0 to \$15,000. Division documentation did not include sufficient information for us to determine the investigators' or Division's reasons for pursuing disciplinary action against some licensed businesses in response to underage marijuana sales, but not others.

Exhibit 2.9 shows a comparison of disciplinary actions taken against both the store and the employee(s) that resulted from the retail marijuana sales to underage individuals in our sample.

Exhibit 2.9

Disciplinary Actions in Response to a Sample of Retail Marijuana Sales to Underage Individuals

Sample #	Disciplinary Action Against Retail Marijuana Store					Disciplinary Action Against Store Employee(s)				Monetary Penalty
	No Action	License Suspension	Responsible Vendor Training	Update Standard Operating Procedures	Identification Scanner Training	No Action	Criminal Summons	License Suspension or Voluntary Surrender	Responsible Vendor Training	Fine Amount
1		•	•	•	•		•	•		\$10,000
2			•	•	•		•			\$10,000
3	•							•	•	\$0
4			•		•	•				\$10,000
5		•	•		•		•			\$15,000
6		•	•	•	•		•			\$7,500
7	•						•			\$0

Source: Office of the State Auditor analysis of seven sampled sales of retail marijuana to underage individuals.

- Issues with Aggregate Data**—The Division does not track aggregate data on specific violations that investigators identify evidence of during underage compliance checks. Therefore, we could not analyze the extent to which the Division pursued consistent enforcement actions in response to violations associated with marijuana sales to underage individuals for Fiscal Years 2019 through 2022.

Why did these problems occur?

Overall, the Division's processes for determining how violations of marijuana laws and rules should be addressed, as well as how disciplinary actions are tracked, are not structured in a way to facilitate consistency and transparency. We identified several factors that contributed to these issues, as discussed in the next sections.

The severity of all possible violations has not been defined. Provisions in Department rule reflect an intent that the severity of a violation be considered as a factor in how marijuana laws and

rules are enforced. When Division staff find evidence that marijuana laws or rules have been violated, “The State Licensing Authority will make determinations regarding the type of penalty to impose based on the severity of the violation” [1 CCR 212-3, Rule 8-235]. Division policy also lists the severity of violations as a factor that investigators should consider when deciding how to respond to violations [Division Policy, MED-F12]. However, more than half (58 percent) of the alleged violations that the Division investigated from Fiscal Years 2019 through 2022—or 216 of the 375 alleged violations—have not been categorized a level of severity in rule. For example, rule outlines requirements for transportation of marijuana but does not state a severity level for infractions related to transporting marijuana. As a result, both Division investigators and the State Licensing Authority lack documented guidance on classifying the severity of violations they investigate, which in turn could help ensure that their enforcement decisions are appropriate and consistent.

Division management told us that the rules establishing penalties based on a violation’s severity “are intended to provide transparent guidelines for the State Licensing Authority and licensees to understand the potential consequences of verified violations, but do not serve as a mandate for penalties for each alleged violation.” Even if a violation’s severity is only one factor that can influence what penalties might be assessed, to achieve greater transparency about how specific requirements could be enforced, defining the severity of at least some violations, such as those that affect public health and safety, should be established in rule.

The Division lacks clear guidance on how investigators should respond when they identify regulatory violations. According to Division management, the Division’s enforcement philosophy is to promote compliance through education, rather than strict disciplinary action, but also that licensees who violate marijuana laws and rules should be subject to progressive discipline. To help educate licensees about their requirements, Division investigators who identify violations can issue a verbal warning in response to license infractions, the least severe type of violation [Division Policy, MED-F12]. Investigators also have broad discretion, with approval from a supervisor, to provide “a written warning in lieu of recommending immediate administrative action,” regardless of a violation’s severity [1 CCR 212-3, Rule 8-120(A)]. However, neither rule nor Division policy provide guidance on which types of violations are not appropriate to resolve with a verbal warning, or examples of when educating licensees through a verbal warning, rather than pursuing progressive discipline through disciplinary action, would be appropriate.

The Division told us that there are circumstances when license violations affecting public safety should not be resolved through a verbal or written warning, such as a sale of marijuana to an individual under age 21. However, there have been other circumstances when the Division deemed it appropriate to address a license violation affecting public safety with a warning. For example, one licensee had a reporting issue with their point-of-sale system, so marijuana sales were not updated in the Division’s inventory tracking system for 2 days. Once a Division investigator pointed out that issue, the licensee uploaded the sales information and provided documentation that the issue had been resolved with the vendor who provided the licensee’s point-of-sale system. Even though the

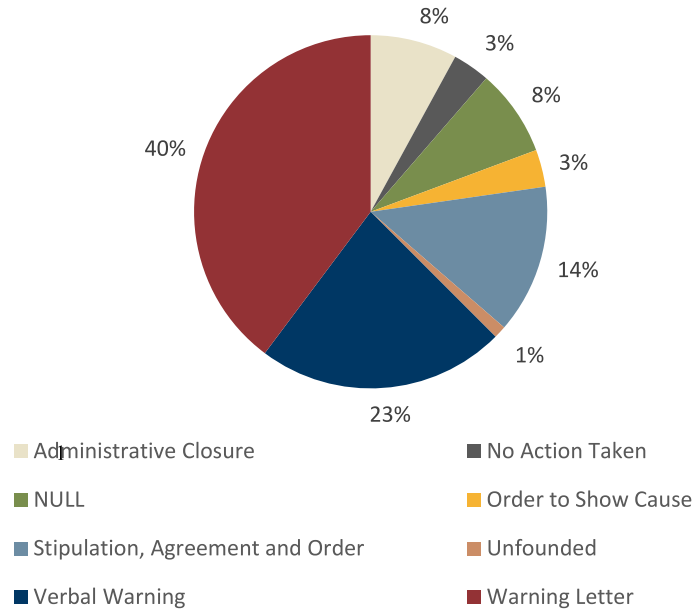
omission of sales to the inventory tracking system is a license violation affecting public safety, the licensee corrected the issue, demonstrated that those issues would not be ongoing, and did not have a history of noncompliance with marijuana laws or rules. Therefore, the Division did not feel it was appropriate to address the violation through disciplinary action, such as license suspension or revocation, or a fine. Documenting guidance to help investigators navigate the unique factors surrounding each licensee they investigate and any violations they identify could help ensure that investigators make consistent, appropriate disciplinary decisions.

Neither rule nor Division policy contain guidance on the severity of at least certain violations, options for appropriate disciplinary actions, and mitigating factors that investigators should consider when deciding how to respond to violations they observe. Given that Department rules exceed 500 pages, providing summarized guidance that investigators could reference during investigations could help them make real-time decisions about how to respond when they identify violations. During our site visits to the Division's four regional offices, investigators told us that it can be challenging to maintain up-to-date knowledge about all of the regulatory requirements for marijuana businesses because the rules are voluminous—and new requirements are regularly added to rule.

The Division does not track data about violations in a meaningful way. Our analysis of the Division's aggregate data found that the field where investigators select an alleged violation type from a drop-down menu does not describe all violations in a way that aligns with how the violations are described in rule. This also makes it difficult to review aggregate data on violations to assess the appropriateness of the associated disciplinary actions. For example, one type of investigation into alleged violations that Division investigators can select is "regulatory violation," which could potentially refer to a violation of any Department rule. Of the 375 investigations into alleged violations that the Division investigated from July 2018 through June 2022, almost one-fourth, or 88 investigations into alleged violations, were categorized as regulatory violations. As shown in Exhibit 2.10, the Division's response to those 88 investigations into alleged violations varied widely, making it difficult to determine if those actions appropriately addressed the nature of each violation.

Exhibit 2.10

Disciplinary Actions in Response to Alleged Violations Categorized as Regulatory Violations



Source: Office of the State Auditor analysis of Division data.

¹ Division investigation records with “null” values included six violations in response to which the Division was still pursuing disciplinary action, and one investigation that was closed without a disciplinary action entered into MyLO.

Other options in the drop-down menu describe investigations into alleged violations too generally, so there is no way to reliably determine which requirements were violated. For example, investigators must select either “METRC violation” or “METRC clean-up” to refer to types of investigations into alleged violations associated with inventory tracking. Department rule differentiates between “making misstatements or omissions in the Inventory Tracking System,” which are considered license violations affecting public safety, and “minor or clerical errors in the Inventory Tracking System,” which are categorized as less severe license violations. However, there is no way to tell which violation category in MyLO aligns with which rules related to inventory tracking.

During the 2023 Legislative Session, the General Assembly appropriated \$1 million for the Division to procure new licensing and case management software [Senate Bill 23-214]. The Division should include provisions in its Request for Proposals (RFP) for the new system requiring that the system be programmed with the capability to store and report data related to specific violation types that are substantiated through Division investigations.

Why do these problems matter?

Regulation of Colorado's marijuana industry that is inconsistent or not conducted in a transparent way could create a perception of unfairness if some licensees are penalized more severely than others for the same types of violations.

In addition, the Division's decision to not pursue disciplinary action in response to investigations into alleged violations of laws or rules—particularly those that affect public health and safety—could send a message that licensed marijuana businesses might not be held accountable for violating marijuana laws and rules. Not consistently pursuing appropriate disciplinary action when Division investigators find evidence of alleged violations of marijuana laws or rules could also undermine the Division's ability to deter regulated marijuana businesses from engaging in prohibited activity, such as selling to underage individuals or diverting marijuana to the black market. Not responding to the most serious violations consistently also undermines the Division's ability to fulfill its mission, which includes promoting public safety and reducing public harm.

Recommendation 2

The Marijuana Enforcement Division (Division) should ensure that it regulates Colorado's retail marijuana industry in a consistent and transparent manner by:

- A. Working with the State Licensing Authority (i.e., Executive Director of the Department of Revenue) to revise rules so they (i) clearly specify which violations are considered to be the highest severity, and (ii) reference violations that are not appropriate to resolve with a verbal or written warning.
- B. Revising Division policy to (i) specify which violations are considered to be the highest severity versus other types of violations that may warrant a broader range of actions informed by aggravating and mitigating factors, (ii) specify which types of violations would not be appropriate to address through a verbal or written warning, and (iii) provide guidance on how Division investigators should identify and assess mitigating or aggravating factors that could influence which disciplinary action to recommend.
- C. Including in its Request for Proposals that the Division's new licensing system be programmed with the capability to store and report data related to specific violation types that are substantiated through Division investigations, and incorporating this functionality in the new system if deemed available and cost-effective.

Response

Marijuana Enforcement Division

A. Agree

Implementation Date: January 2025

The Division has taken several measures to enhance transparency and ensure consistent administration of its regulatory duties, demonstrated by:

- Publishing final agency actions to its webpage
- Stakeholder communications in the form of Compliance Tips, Health & Safety Advisories, and newsletter updates regarding compliance trends, enforcement issues, and engagement opportunities
- Publishing a dashboard with underage compliance data.

The above noted measures are complementary to the OSA's recommendation. To implement the recommendation, the Division will coordinate with its policy team, investigations teams, Office of the Attorney General representatives, and State Licensing Authority to conduct a comprehensive review of its rules to identify violations and factors that (i) should be designated as the highest severity, including violations that should receive recommendations for the most severe penalties; and (ii) are not appropriate to resolve with a verbal or written warning. Following this review and preparation, the Division will include this initiative in its 2024 annual rulemaking, to allow for stakeholder awareness and input as required by the Administrative Procedure Act. And consistent with Division practice, following the adoption of amended rules, the Division will deliver staff training and engage in a communications plan to reinforce stakeholder/public awareness, providing training and resources as appropriate for interested parties.

Taking into account the Division's annual rulemaking schedule, the preparation required to implement the recommendation, and the requirements of the Administrative Procedure Act, the Division anticipates it can fully implement the OSA's recommendation by January 2025 (as the effective date for updated rules).

B. Agree

Implementation Date: July 2024

The Division addresses alleged non-compliance through a range of intervention strategies with a focus on protecting public safety. When determining the appropriate approach, the Division evaluates a variety of factors - including impacts to public safety, evidence of willful/deliberate

action, identified mitigating and aggravating factors, consideration of similarly situated cases, and the likelihood for sustained compliance.

Even with cases that appear similar in nature, the Division believes it's important that distinct facts of each case are taken into account when considering enforcement approaches and resolution opportunities (e.g., self-reporting, compliance history, prior-established mitigation measures initiated by licensees, such as training and standard operating procedures). The Division recognizes it can improve on how it documents the bases for its approach, particularly when it involves the same categories of rules/violations.

The Division will work to implement the OSA's recommendation by: (i) Reviewing and revising policies to provide clearer guidance regarding which violations are considered to be the highest severity versus violations that may warrant other actions based on aggravating and mitigating evidence; (ii) specifying in policy the types of violations that would not be appropriate to address through a verbal or written warning; and (iii) establishing training and accountability measures to support consistent administration and expectations that Division leadership and supervisors provide guidance and support on how to identify, assess, and document mitigating and aggravating factors that inform consistent enforcement and resolution recommendations.

C. Agree

Implementation Date: June 2026

The Department will include in its Request for Proposals that the Division's new licensing system be programmed with system functionality necessary to store and report data related to specific violations that have been substantiated, subject to fiscal and system capabilities/operability.

Finding 3—Sole Source Procurement

Statute requires the Department to develop and maintain a system that tracks both retail and medical marijuana—known as regulated marijuana—from the seed or immature plant stage through its sale in the regulated market, a process generally referred to as “seed-to-sale tracking” [Section 44-10-202(1)(a), C.R.S.]. The Department promulgated a rule further defining that the seed-to-sale-system should be “a web-based tool coupled with radio frequency identification (RFID) technology that allows both the Inventory Tracking System User and the State Licensing Authority the ability to identify and account for all Regulated Marijuana” [1 CCR 212-3, Rule 3-805]. After issuing an RFP in 2011, the Department awarded a \$1 million, 7-year contract to a company called Franwell, now called Metrc LLC, to develop, implement, and provide ongoing support for a seed-to-sale RFID tracking system called the Marijuana Enforcement Tracking Reporting Compliance System (METRC). Metrc LLC began developing the web-based tracking platform in 2011, and the system was implemented alongside the launch of regulated retail marijuana sales in 2014. Metrc LLC

maintains exclusive rights to the core system they developed for the State of Colorado, but any customizations made to meet Colorado’s regulatory needs are owned by the State.

In anticipation of the original contract’s expiration date on October 31, 2018, staff within the Department’s Financial Services Division, which handles procurement and contracting for the Division, determined that there was justification to award a new contract to the current vendor without competition. A contract that is awarded for a service without competition is referred to as a sole source procurement [Section 24-103-205, C.R.S.].

In October 2018, the Department executed an 8-year contract totaling \$856,000 with Metrc LLC to continue providing ongoing support, licensing, and hosting services for the METRC system. This contract expires in 2026. In addition, the Department entered into two no-cost contracts with Metrc LLC to provide training and support services for licensed marijuana businesses and employees, and to supply specialized RFID tags for regulated marijuana plants and packages for licensees. The costs of both of these contracts are paid directly by licensees to Metrc LLC and do not use Division funds; therefore, we did not review these contracts during the audit.

What audit work was performed, what was the purpose, and how were the results of the audit work measured?

We reviewed relevant criteria related to sole source procurements (statutes, rules, State Controller Procurement Policies, Department purchasing and contracts guidance), reviewed procurement and contract documentation related to the Department’s 2011 and 2018 contracts with Metrc LLC, researched vendors that provide marijuana seed-to-sale tracking systems to state regulators, and interviewed Department and Division staff. The purpose of our audit work was to determine if the Department complied with state procurement requirements in statute and rules in 2018 when it entered into a second contract with Metrc LLC to provide its seed-to-sale marijuana inventory tracking system, METRC.

When conducting our audit work, we considered the following:

One purpose of the State Procurement Code is to “foster effective broad-based competition within the free enterprise system.” [Section 24-101-102(2)(e), C.R.S.]. The State of Colorado Procurement Code of Ethics endorses competition, stating that state employees, who purchase goods and services, should “provide an environment where all business concerns...are afforded an equal opportunity to compete for business with the State.”

Any seed-to-sale tracking system that the Department implements is considered a personal service under State Fiscal Rules, which specify that major information technology projects are considered a type of personal service [1 CCR 101-1, Rule 3-3 (2.14)]. Statute defines a major information technology project as “a project that considers risk, impact on employees and citizens, and budget,

and that includes at least one of the following: A complex set of challenges, a specific level of business criticality, a complex group or high number of stakeholders or system end users, a significant financial investment, or security or operational risk. A ‘major information technology project’ includes, without limitation, implementing a new information technology system or maintaining or replacing an existing information technology system” [Section 24-37.5-102(19), C.R.S.].

Statute allows state agencies to award a personal services contract without competition if only one good or service can reasonably meet the procuring agency’s need, and only one vendor can provide that good or service, a process known as “sole source” procurement [Section 24-103-205, C.R.S.]. Procurement rules that were in effect in 2018, when the sole source contract was awarded, also stated, “A sole source procurement is justified when there is only one good or service that can reasonably meet the need and there is only one vendor who can provide the good or service. A requirement for a particular proprietary item (i.e., a brand name specification) does not justify a sole source procurement if there is more than one potential bidder or offeror for that item” [1 CCR 101-9, R 24-103-205-01(a)].

To help ensure that other potentially qualified vendors are identified before awarding a sole source contract, statute states that “prior to entering into a sole-source personal services contract, the governmental body shall attempt to identify competing vendors by placing a notice on the state’s electronic procurement system for not less than three business days. If the governmental body receives any responses to the notice from qualified and responsible vendors that are able to meet the specifications identified in the notice and that are not otherwise prohibited from bidding on the contract, the sole-source selection method shall not be used” [Section 24-106-103(5), C.R.S.]. Thus, to accomplish the intent of the posting requirement, it is reasonable to expect that the notices should specify the services sought.

According to a procurement official we interviewed at the Office of the State Controller (OSC), if a state agency plans to award a sole source contract for ongoing maintenance of an existing IT system, OSC staff said it is acceptable for the agency to award a sole source contract as a stop gap, as long as the agency has a longer-term plan to use a competitive bidding process for future procurements. Further, the OSC procurement official stated that the scenario of an agency liking a particular system the best is not a justified reason to award a sole source contract.

Before awarding a sole source contract, the agency procurement official or his or her designee must determine in writing that there is only one source for the needed service and set forth the reasons [Section 24-103-205, C.R.S. and 1 CCR 101-9, R-24-103-205]. In cases of reasonable doubt, competition should be solicited [1 CCR 101-9, R-24-103-205]. Any request by an agency that a procurement be restricted to one potential contractor shall be accompanied by an explanation as to why no other contractors will be suitable or acceptable to meet the need [1 CCR 101-9, R-24-103-205]. The Department uses a sole source justification form to document its written determination that a sole source procurement is appropriate, which must detail why only one product or service

will meet the Department's need and why there is only one vendor who can provide that product or service.

What problem did the audit work identify?

We found that the Department did not appear to comply with state procurement requirements in 2018 when it contracted for a seed-to-sale inventory tracking system because its documentation does not support a sole source procurement. Specifically, we found:

- **The sole source justification did not address why METRC was the only seed-to-sale tracking system on the market that could meet the Department's needs.** Rather, the documentation indicated that the Department had decided to continue using the METRC system and to award a sole source contract to purchase ongoing support, licensing, and hosting for that system. The Department's sole source justification stated, "Franwell's [Metrc LLC's] system is proprietary. The complexity of state statutes and regulations, mandating the commercial marijuana market make it critical that any inventory tracking system used in marijuana enforcement be designed primarily for regulator use and secondarily for industry use. The State owns the customizations to the system. Franwell, Inc. [Metrc LLC] is the owner of METRC and is the only vendor who can provide ongoing support, licensing, and hosting services for their own proprietary system."

During our audit, Department staff reported other reasons for awarding a sole source contract to Metrc LLC, including that Metrc LLC was the only contractor that worked exclusively with regulators, the METRC system includes customizations to meet the State's technology needs (e.g., notifications related to a licensee's on-hand marijuana inventory and enhanced traceability functions to support product recall efforts), and several product testing-related enhancements. In addition, Department staff stated that informal market research conducted in 2018 found that other seed-to-sale systems on the market were not coupled with RFID technology, which Department rule requires. However, we found documented evidence from 7 years earlier showing that during the Department's 2011 process to procure its seed-to-sale inventory tracking system, Department staff who scored proposals noted that three other vendors besides Franwell/Metrc LLC had systems that were equipped to handle RFID technology. For example, on one scoring sheet, when describing one of the vendor's strengths, Department staff wrote, "Company has extensive experience with RFID" and "Very solid experience providing RFID hardware and asset tracking solutions." Documentation in the Department's 2018 procurement file, including the sole source justification, made no mention of Department staff's prior knowledge about companies other than Metrc LLC that could potentially offer seed-to-sale inventory tracking systems with RFID technology.

However, the sole source justification itself did not include any of the points that Department staff communicated to us during our audit, any documentation of the informal market research,

and the justification did not explain how the Department determined that there were no other potential bidders that could provide a marijuana inventory tracking system coupled with RFID technology. In fact, the Department's procurement documentation included evidence that staff became aware of at least one other vendor who reported that they could provide a seed-to-sale tracking system for the 2018 contract. One day after the Department published its Notice of Proposed Sole Source, a vendor representative emailed Department staff stating, "We provide statewide marijuana tracking systems for several states across the country. We are interested in finding out more information on this solicitation, particularly how we can contest the decision to sole source." Department staff responded to the email by stating, "The NPSS [Notice of Proposed Sole Source] is for the ongoing support, licensing, and hosting services for the proprietary METRC system. The Department intends to purchase the services from Franwell, Inc. [Metrc LLC] who is the owner of METRC and the only vendor who can provide the services for their proprietary system. Are you stating that your company is able to provide maintenance services for the Franwell [METRC] system?"

The vendor replied, "We develop technology for state agencies that is nearly identical in function to METRC with distinguishing factors that set us apart. It is my understanding that Metrc [LLC]'s contract with the DOR (Department of Revenue) ends in October of this year. I was under the impression that the DOR has chosen to sole source Metrc [LLC] for a new contract for statewide tracking. We would like the opportunity to competitively bid on this contract if at all possible." According to the vendor's website, that vendor can currently provide a seed-to-sale inventory tracking system that is able to operate with a variety of tags and tag systems. It is unknown if the vendor could have provided a system with RFID tags back in 2018 since the Department did not have documentation to indicate whether it pursued further clarification or details from the vendor on their RFID capabilities.

Since the purpose of publicizing a Notice of Proposed Sole Source is to identify potential competitive vendors, the Department missed an opportunity to learn about whether another vendor's product could have addressed the Department's broader statutory need for a marijuana inventory tracking system and the Department's regulatory need for a system coupled with RFID technology. Becoming aware that another contractor's product might be suitable to address the Department's need could have created enough reasonable doubt for the Department to conclude that a sole source procurement was not appropriate. Nonetheless, Department staff stated that the procurement official's signature on the sole source justification signified their conclusion that the justification presented sufficient facts, circumstances, and reasoning to justify why no other contractor would be suitable or acceptable to meet the need.

- **The Department's long-term procurement plan noted in 2011 contract documents was to award a sole source contract to Metrc LLC in 2018, rather than pursue a competitive bidding process.** On the Department's Request for Contract Signature form that accompanied an amendment to the original contract that was executed in August 2011, the form stated that the "Future Procurement Plan" for the contract was "Sole Source." According to the

Department, this was added to the form based on its knowledge of the seed-to-sale market at that time. In addition, before the original contract with Metrc LLC expired in October 2018, the Department would have needed to request funding to potentially replace the METRC system in case a competitive bidding process identified a different vendor to implement a marijuana inventory tracking system coupled with RFID technology. However, the Department's Fiscal Year 2018 budget request did not contain any requests for funding related to potentially replacing METRC. Department staff confirmed that they did not request an IT capital appropriation for a new marijuana inventory tracking system because the METRC system was meeting the Division's business needs and based on its understanding of the market.

The Department disagrees that it should have used a competitive bidding process to award the 2018 contract since the sole source justification was structured around the need to purchase ongoing support, licensing, and hosting for the METRC system, rather than obtaining information about other vendors that could potentially provide a marijuana inventory tracking system coupled with RFID technology. Further, Department staff reiterated that the procurement manager's signature on the sole source justification signified that sufficient reasoning was provided to substantiate the sole source determination and that informal market research had been conducted to determine that no other prospective bidders were offering similar products. However, the procurement file did not contain any other documentation of market research that Department staff might have performed in 2018.

During our audit, we conducted online research and identified four companies, including Metrc LLC, that were under contract prior to 2018 to provide seed-to-sale tracking systems to other states with regulated marijuana. Department staff told us that they were aware of other vendors, but felt that continuing with Metrc LLC was in the best interest of the State; however, neither this assertion nor supporting evidence demonstrating why the other systems and vendors were not in the best interest of the State were reflected in the sole source justification.

Why did this problem occur?

The Department's purchasing process did not ensure that a sole source procurement was justified. Although the Department has written purchasing guidance stating that procurement staff must complete a sole source justification form, the guidance does not explain how procurement staff should determine when a sole source procurement is appropriate, what information is needed to support that decision, and what information should be documented in the sole source justification to clearly demonstrate that the sole source procurement satisfied requirements in statute and rule.

Further, while Department guidance states that market research may be a valuable tool even outside of situations where formal market research is statutorily required, and that procurement staff should rely on Division staff's expertise to keep up-to-date on industry conditions and potential vendors,

there is no guidance on if or how the Department should conduct and use market research in sole source procurements. Department staff told us that while formal market research was not required for this procurement, Division staff provided informal market research during the procurement process based on their knowledge of the marijuana industry. However, there was no documentation of the informal market research or the information provided by Division staff in the procurement file.

Department and Division staff also reported that since the market for marijuana seed-to-sale tracking systems was evolving at the time of the procurement, there were no other vendors besides Metrc LLC that could provide a seed-to-sale tracking system coupled with RFID technology. Since the Procurement Code and the Department's sole source justification process did not require procurement staff to conduct formal (documented) market research to identify qualified vendors at the time of soliciting bids, procurement staff did not cite any market research in the sole source justification to support the conclusion that continuing to contract for the existing METRC system was necessary since no other vendor could provide the required RFID technology.

However, the audit team gathered information about other vendors from company websites, news articles, and press releases. Of the four companies we identified in our research that were providing seed-to-sale tracking systems to other states with regulated marijuana, at least one vendor other than Metrc LLC was under contract to provide another state seed-to-sale tracking using RFID technology. Additionally, another vendor that had contracts in at least five other states to provide seed-to-sale tracking prior to 2018, claimed that their system was compatible with RFID technology. The Department questioned whether these competing systems had the capability to satisfy the requirement that the seed-to-sale tracking system be coupled with RFID technology, which could have been answered if they had documented their market research of other competing systems.

Staff also told us that they relied on approval they obtained from the OSC to support their decision that a sole source was the proper procurement method for the inventory tracking system. However, emails we reviewed indicated that the focus of the Department's correspondence with OSC was to obtain approval to award an 8-year contract to Metrc LLC, which requires OSC approval per rule [1 CCR 101-9, R-24-106-105], rather than seeking confirmation about whether sole source was the appropriate procurement method. Implementing a more comprehensive policy to guide the sole source approval process could provide staff greater assurance that their procurement decisions are appropriate and comply with state requirements.

Why does this problem matter?

The State Procurement Code's purpose, as stated in statute, includes providing for increased public confidence in the procedures followed in public procurement, ensuring fair and equitable treatment of all persons who deal with the State's procurement system, maximizing the purchasing value of public funds, and fostering effective broad-based competition within the free enterprise system

[Section 24-101-102, C.R.S.]. The Department's purchasing guidance also reiterates that "sole source situations are uncommon" and that "purchasing processes are meant to encourage competition." When an agency does not have documentation to show that it followed the Procurement Code and associated guidance in procuring goods and services, this can undermine the State's ability to fulfill these principles.

By not offering a competitive bidding process for its seed-to-sale tracking system, the Department did not afford other vendors the opportunity to compete for the State's business. Without competition, it is possible that the Department missed an opportunity to obtain a comparable system that was more advantageous to the State. Since the Department obtained approval from the OSC to extend the hosting contract with Metrc LLC for up to 8 years, this means that other companies in the marketplace that provide marijuana seed-to-sale tracking systems could potentially not have another opportunity to compete for the State's business until Fiscal Year 2027.

Recommendation 3

The Department of Revenue (Department) should ensure that it complies with state procurement requirements when procuring the Marijuana Enforcement Division's (Division) seed-to-sale inventory tracking system by revising its purchasing guidance to explain how staff should determine when a sole source procurement is appropriate, what information is needed to support that decision, and what information should be documented in sole source justifications.

Response

Department of Revenue

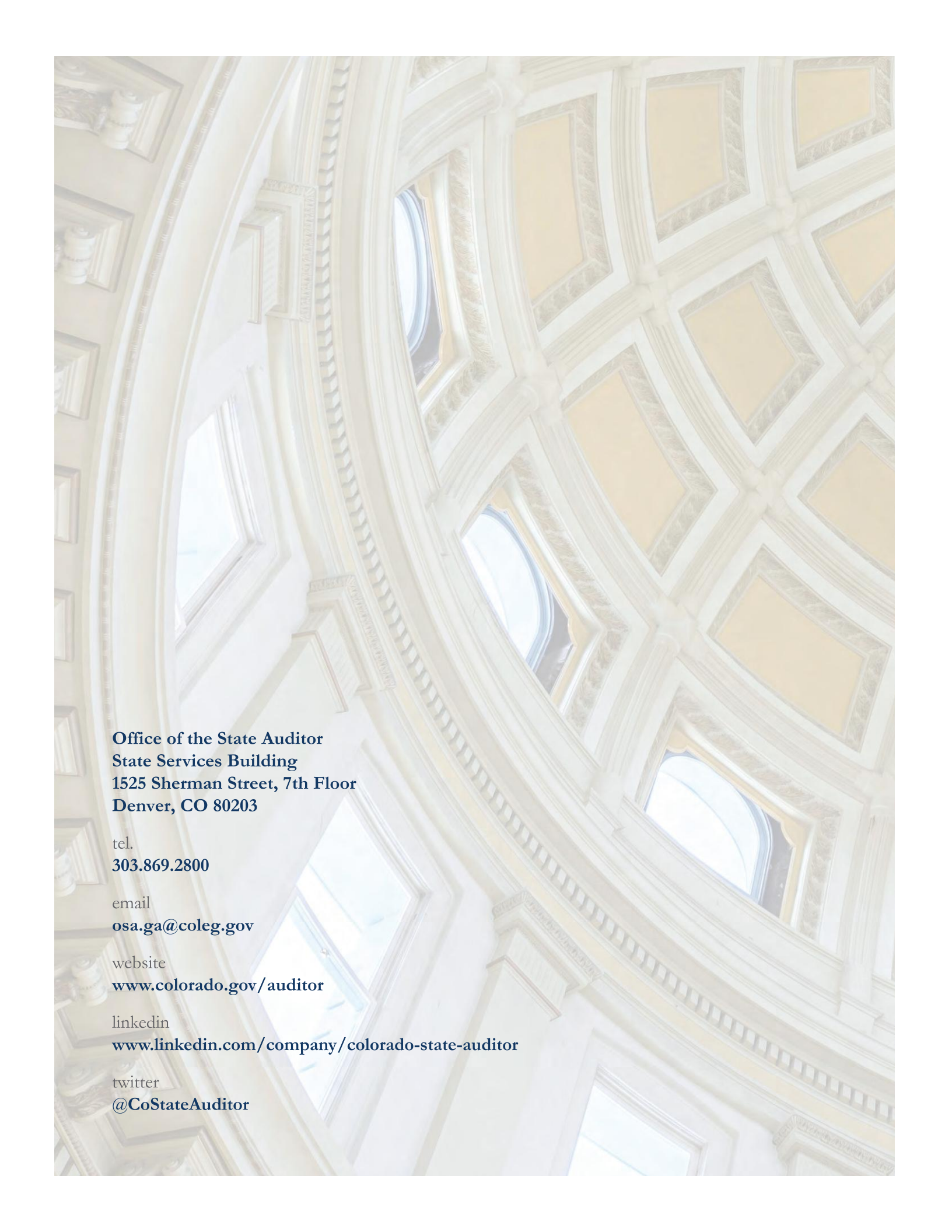
Agree

Implementation Date: January 2024

The Department maintains that in 2018 a sole source contract was justifiable for its seed to sale tracking system and that METRC was the only system that could meet the Department's needs pursuant to the Marijuana Enforcement Division's regulations. Research showed that there were no equivalent systems in the market. There were vendors that offered RFID compatibility point of sale systems to marijuana stores, which is different from the ability to offer RFID technology. There were no competing systems identified that could provide a regulatory seed to sale tracking system coupled with RFID technology as required in Rule 3-805. Rules require licensees to use RFID plant and package tags for regulatory monitoring and to support the Division's ability to trace the origin of inventory - for example, in cases of adverse health events, testing compliance issues, and evidence of diversion responsive to federal priorities. The Division intends to propose amending rules to allow for broader consideration of track and trace technology beyond RFID.

The Department met all the requirements in the State Procurement Code in this sole source; however, the research was not documented in the procurement file as formal (documented) market research was not required by Procurement Code in January, 2018. The Department will revise its purchasing guidance to explain how staff should determine when a sole source procurement is appropriate, what information is needed to support that decision, and what information should be documented in sole source justifications.





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