

## Identifying causes of inventory shrinkage in a retail cannabis business

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# Addressing tools to discover the cause of inventory shrinkage

## Introduction

Inventory shrinkage challenges cannabis businesses, and seed-to-sale tracking solutions are not designed to address the problem. Employee theft and diversion for illicit sales are a risk that cannabis businesses are concerned about and trying to address. This case study will look at one dispensary issue and the time spent addressing the issues, the cost, the solution used, and the outcome.

In January of 2022, a licensed dispensary in California reached out to Clarion Compliance to discuss concerns regarding inventory shrinkage. In our initial discussions with the ownership, we found that their inventory records were not reconciling, and they did not know whether the issue was:

- Miscounting
- Theft by an employee for personal use
- Theft by customer
- Theft by an employee to be sold in the illicit market

**Inventory issues are the number one problem that continually challenges a cannabis business and requires considerable resources to address**

## Crafting the action plan

This dispensary used a point-of-sale program that registered sales, kept track of stock levels, and had a reconciliation component built-in. The dispensary had the METRC program in use as is required in California, and the POS system communicated with METRC, which reported to the state.

The inventory reconciliation process was found to be somewhat lax, and there were no standard operating procedures (SOPs) in effect for inventory reconciliation. Basic SOPs were on file, but the company did not refer to them for training or compliance purposes. There was no system in place to investigate inventory shrinkage if or when it was discovered.

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*The total time spent with senior management for this phase was one hour*

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Internally we decided that the best course of action was to monitor inventory remotely to identify patterns and anomalies that might bring issues to light. This approach meant that there would be no staff time required by the dispensary's compliance person or senior stakeholders and would address their time constraint concerns and overall working atmosphere with the employees.

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## Implementation of our solution

Clarion Compliance utilized a read-only solution that we deployed remotely with no assistance from the client or time involvement on their part. We utilized our real-time monitoring solution, and we monitored the account for 60 days and discovered anomalies in the data that were elevated to red flag status. After 90 days, we had made the following determinations from the physical evidence:

- Certain employees were removing products from inventory and altering the records in a particular fashion
- There were two types of products that were particularly appealing and had a shrinkage percentage much higher than random shrinkage events
- The volume of product taken and the time frame for that product indicated the theft was for illicit sales activity rather than attributed to personal use
- Total inventory losses were approximately \$9,000 per month at the wholesale level.

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*The total time spent by Clarion personnel to address these issues was 3 hours per month for 3 months*

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## Further discussion

Dispensary leadership was surprised to find that they had been losing about \$9,000 per month for more than a year. They found that \$108,000 in product theft was unacceptable and negatively affected their cash flow. Leadership was also relieved that Clarion had found the problem for them and that they were able to address the issue outside of regulatory scrutiny and avoid possible fines for inventory irregularities.

Comparing our solution to their POS system, leadership concluded that they could not have discovered the cause of the problem independently, as their POS system was not designed for that purpose, nor was METRC.

Dispensary leadership decided to put better compliance assurance controls in place to address the issue so that employees knew that inventory issues like this would be discovered immediately. Leadership further decided not to disclose the identity or magnitude of the problem but rather train its management and stakeholders on their new procedures to ensure this activity would not continue and no one would lose their employment in these difficult times.

Dispensary leadership was relieved that their time commitment was low and the costs to address this problem were reasonable. They decided to continue the monthly monitoring by Clarion Compliance to identify future problems at the earliest moment.

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## Conclusions

The total cost for the initial consultation and the three months of monitoring was \$2,575.00, and the ongoing monitoring fee is \$75.00 per month. The time commitment by the dispensary owners was kept very low to avoid disruption, with one hour up front and two additional hours at the conclusion of the assignment. The ongoing monitoring requires no time commitment and no outlay beyond the \$75.00 per month fee, provided no issues are uncovered. Leadership did contract with Clarion Compliance outside of this assignment to help mature their inventory control system and assurance practices.

Overall, we found that an outlay of \$2,575.00 to uncover inventory losses of \$108,000 was a wise commitment of resources on the part of the dispensary ownership.

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***Total outlay to discover \$108,000 in losses was \$2,575.00***

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