

Division of Gaming
Department of Revenue

Performance Audit
October 2011



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The mission of the Office of the State Auditor is to improve the efficiency, effectiveness, and transparency of government for the people of Colorado by providing objective information, quality services, and solution-based recommendations.



October 14, 2011

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Division of Gaming. 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. The report presents our findings, conclusions, and recommendations, and the responses of the Division of Gaming and the Limited Gaming Control Commission.



We Set the Standard for Good Government

Glossary of Terms and Abbreviations

ACL – Audit Command Language

Department – Department of Revenue

Division – Division of Gaming

Gaming Act – Colorado Limited Gaming Act of 1991

Gaming Commission – Limited Gaming Control Commission

Payment Intercept Act – Gambling Payment Intercept Act

W-2G – W-2G tax form



DIVISION OF GAMING

Performance Audit, October 2011

Report Highlights



Dianne E. Ray, CPA
State Auditor

Division of Gaming
Department of Revenue

PURPOSE

Evaluate whether the Limited Gaming Control Commission's (the Gaming Commission) process for issuing multiple casino licenses meets legislative intent, and the effectiveness and efficiency of the regulatory activities performed by the Division of Gaming's (the Division) Audit, Investigations, and Field Operations Sections.

BACKGROUND

- Colorado voters approved constitutional amendments in 1990 and 2008 authorizing limited and extended casino gaming, respectively.
- The Gaming Commission is responsible for administering and regulating gaming in Colorado, including promulgating gaming rules and regulations; establishing the gaming tax; licensing gaming owners, manufacturers, and employees; and imposing enforcement and corrective actions against licensees.
- The Division is responsible for processing license applications, implementing and enforcing gaming statutes and regulations, and supervising the conduct of casinos.
- The Gaming Commission has established a graduated gaming tax on individual casinos' adjusted gross proceeds. Over the last 5 fiscal years, gaming tax revenue paid to the State averaged about \$106 million per year.

OUR RECOMMENDATIONS

The Gaming Commission should:

- Eliminate the tax advantage gained by ownership groups with multiple physically attached casinos.

The Gaming Commission partially agreed with this recommendation.

The Division of Gaming should:

- Determine the purpose and need for each of its data systems and eliminate unnecessary and duplicative systems.
- Implement a process to ensure it meets its goals for completing regulatory reviews and utilizes staff efficiently.

The Division agreed with these recommendations.

AUDIT CONCERN

The Gaming Commission should make regulatory changes to ensure that casino owners pay gaming taxes in an equitable manner, and the Division should improve its operations and regulatory activities to strengthen oversight of Colorado's casinos.

KEY FACTS AND FINDINGS

- The Gaming Commission's current tax and licensing structures allow owners of multiple attached casinos to gain a competitive advantage over owners of other casinos.
- The Division's data systems for tracking casino oversight activities contain inaccurate, incomplete, and overlapping data. Specifically, we found problems with completeness and accuracy in three of the Division's five data systems. As a result, the Division's ability to utilize its data and produce accurate reports of its regulatory activities for the Gaming Commission is limited.
- The Division did not conduct oversight activities at some casinos to gain assurance that all casinos were reporting revenue accurately for gaming tax purposes. Specifically, none of the 41 casinos operating in Fiscal Year 2010 received all applicable regulatory reviews. Additionally, 10 (24 percent) of the 41 casinos did not receive audits or reviews of the highest-risk accounting areas.
- The Division's method for determining casino compliance with the Gambling Payment Intercept Act—which requires casinos to search a database of persons owing child support before paying a certain level of winnings to patrons—does not provide consistent and reliable results or ensure timely compliance. As a result, the Division cannot reliably identify the casinos that do not adequately perform searches, determine the precise reasons why casinos do not perform adequate searches, or take appropriate enforcement action to ensure compliance.

FINANCIAL BENEFITS

The State could have collected about \$4.9 million more in gaming taxes in Fiscal Year 2010 if casino owners had operated their attached casinos under one casino retail license or if their attached casinos had been taxed under one license.

Casino Gaming Regulation

Colorado voters approved a constitutional amendment (Colorado Const., art. XVIII, sec. 9) in 1990 authorizing limited casino gaming in the commercial districts of the Colorado mountain towns of Central City, Black Hawk, and Cripple Creek. Implemented in October 1991, limited stakes gaming allowed casinos to operate in Colorado but restricted the amount of space they could dedicate to gaming, the architecture of their gaming structures, their hours of operation, the types of games they could offer, and the maximum single bet allowed by players. The constitutional amendment (Colorado Const., art. XVIII, sec. 9) also created the Limited Gaming Control Commission (the Gaming Commission) to administer and regulate gaming in Colorado, including, but not limited to, licensing casinos to operate and assessing gaming taxes on casino revenue.

To change casino gaming in Colorado, including the location, types of games allowed, and betting limits, or to increase gaming taxes above the levels that were in effect on July 1, 2008, requires a statewide vote of the people and an amendment to the State Constitution. In 2008, Colorado voters approved Amendment 50, which allowed voters in the three gaming towns to vote to revise the original limits on casino operations within their districts by extending gaming hours, the maximum bet allowed, and the types of games in operation. Voters in all three cities subsequently approved changes in these areas, known as extended gaming, which became effective in July 2009. The following table outlines the provisions of the limited gaming and the extended gaming laws.

Colorado's Limited and Extended Gaming Requirements		
	Limited Gaming	Extended Gaming
Citation	Article XVIII, Section 9 of the Colorado Constitution and The Limited Gaming Act of 1991	Amendment 50
Effective Date	October 1, 1991	July 2, 2009
Casino Gaming Requirements	<ul style="list-style-type: none"> • Authorized casino gaming in the commercial districts of Central City, Black Hawk, and Cripple Creek • Set player maximum single bet at \$5 • Limited casino games to slot machines and live blackjack and poker card games • Limited casino gaming operating hours to 8:00 a.m. to 2:00 a.m. • Restricted the amount of floor space a casino can devote to gaming • Required casino buildings to conform to pre-World War I architectural styles 	<p>Expanded gaming in the following three areas after the changes were approved by voters in the gaming towns of Central City, Black Hawk, and Cripple Creek:</p> <ul style="list-style-type: none"> • Raised the player maximum single bet to \$100 • Expanded gaming options to craps and roulette table games • Extended casino operating hours to 24 hours per day
Other Provisions	<ul style="list-style-type: none"> • Created the Limited Gaming Fund • Created the Gaming Commission to administer and regulate gaming • Authorized the Gaming Commission to assess gaming taxes and fees • Specified the distribution of limited gaming tax revenue 	<ul style="list-style-type: none"> • Specified that the Gaming Commission could not raise the gaming tax rate above the levels set as of July 1, 2008, without statewide voter approval • Specified how the additional tax revenue generated by extended gaming should be distributed
Source: Office of the State Auditor's analysis of the Colorado Constitution and Colorado Revised Statutes.		

As of the end of Fiscal Year 2011, there were 37 casinos operating in Central City, Black Hawk, and Cripple Creek, with about 14,100 slot machines and 300 table games in play. According to the Division of Gaming (the Division), during Fiscal Year 2011, Colorado's casinos netted about \$754 million in gaming proceeds after paying winning patrons, paid about \$105 million in gaming taxes to the State, and employed approximately 9,600 people in Colorado.

Oversight of Casino Gaming in Colorado

In accordance with the State Constitution, the General Assembly created the Gaming Commission and the Division, within the Department of Revenue (the Department), to enforce gaming regulations; ensure casinos operate honestly, competitively, and free from criminal and corruptive elements; and promote public confidence and trust in Colorado's gaming industry. The Limited Gaming Act of 1991 (the Gaming Act) (Section 12-47.1-101, et seq., C.R.S.) designated specific responsibilities related to overseeing and regulating Colorado's casino

gaming industry to the Gaming Commission and Division. We describe the Gaming Commission and Division below.

Limited Gaming Control Commission

In accordance with Article XVIII, Section 9 of the Colorado Constitution, the General Assembly created the Gaming Commission to administer and regulate limited and extended gaming. The Gaming Act (Section 12-47.1-101, et seq., C.R.S.) designated the Gaming Commission as a Type 2 entity with responsibilities and authority in specific areas, including, but not limited to:

- Promulgating rules, regulations, and internal control procedures governing the licensing, conduct, and operations of gaming in Colorado.
- Establishing and collecting the gaming tax as well as gaming license, gaming equipment, and background check fees.
- Issuing gaming licenses to owners, manufacturers, and employees of limited gaming.
- Inspecting, monitoring, and auditing premises wherein gaming is conducted or gaming equipment is located.
- Imposing enforcement and corrective actions against gaming licensees, including levying fines and suspending or revoking gaming licenses.
- Conducting hearings related to violations of gaming rules, regulations, or the Gaming Act.
- Reviewing and approving the Division's budget each year. The Division's budget is not subject to appropriation by the General Assembly and is provided to the Joint Budget Committee for informational purposes only.
- Continuously studying gaming throughout the state to identify violations of or defects in gaming rules, gaming regulations, or the Gaming Act and recommending changes the Gaming Commission deems appropriate to state officials.

The Gaming Commission is composed of five members appointed by the Governor and confirmed by the Colorado Senate. Gaming Commission members serve 4-year terms and cannot serve more than two consecutive terms. Statute (Section 12-47.1-301, C.R.S.) requires the five members to come from different backgrounds, areas of the state, and political parties. Gaming Commission members must include an attorney with experience in regulatory law, a certified public accountant with knowledge of corporate finance, a law enforcement official, a corporate manager with 5 years of business experience, and a registered voter. Additionally, no two Gaming Commission members can be from the same congressional district, and no more than three can be from the same political party.

Division of Gaming

The Division is responsible for processing licensing applications, implementing and enforcing gaming statutes and the gaming regulations established by the Gaming Commission, and supervising the conduct of casinos in the state. The Division's main office is located in Golden with field offices in the gaming cities of Cripple Creek and Central City, which also covers Black Hawk. In Fiscal Year 2011, the Division had a total of 92 full-time-equivalent staff divided among seven sections, as shown in the table below.

Division of Gaming Sections		
Section	Staffing	Duties and Responsibilities
Accounting	5	Provides accounting and financial services to the Division and the Gaming Commission.
Administration	6	Performs various administrative duties to carry out the Division's day-to-day operations. This section includes Division management.
Audit	14	Conducts casino reviews to ensure compliance with state regulations, statutes, and required minimum internal controls related to accounting and revenue reporting, and conducts revenue audits to ensure casinos accurately report gaming revenue and pay gaming taxes to the State. The Division also requires casinos making \$10 million or more in revenue to undergo annual independent external financial audits, which are reviewed by the Audit Section. According to the Division, in Fiscal Year 2011, this section conducted 10 revenue audits and about 2,200 compliance reviews at casinos.
Field Operations	9	Approves electronic gaming machines and component parts for use in Colorado casinos; monitors revoked, upgraded, and obsolete gaming software; inspects gaming machines to ensure compliance with state regulations and statutes; and oversees forensic evaluations of gaming machines. According to the Division, in Fiscal Year 2011, this section inspected about 5,900 gaming machines and completed about 1,200 compliance reviews.
Technical Systems	5	Approves gaming systems and information technology, such as slot machine monitoring systems, for use in Colorado casinos, and oversees the installation, upgrade, and testing of these gaming systems to ensure compliance with state regulations and statutes. According to the Division, in Fiscal Year 2011, this section conducted 20 system reviews.
Enforcement and Investigations	48	Conducts personal and financial background investigations on businesses and individuals who apply for gaming licenses; performs regular reviews and investigations at casinos to ensure patron and casino compliance with state regulations, statutes, required minimum internal controls related to areas such as surveillance, required casino signage, and underage gaming; and carries out law enforcement duties and criminal investigations at casinos. According to the Division, in Fiscal Year 2011, this section conducted about 1,800 compliance reviews, 1,600 criminal investigations, and 200 background investigations.
Licensing	5	Processes licensing applications and renewals from businesses that request to offer gaming services or products in Colorado and individuals who request to work in Colorado casinos. According to the Division, in Fiscal Year 2011, this section processed about 4,100 new and renewal licenses.
Source: Office of the State Auditor's analysis of information from the Colorado Division of Gaming.		

In addition to their other duties, Division staff provide training in a variety of areas, including internal controls related to table games, cashiers and accounting, and slot machines. Casinos may also request training in other areas. In Fiscal Year 2011, the Division provided 86 training sessions to casinos.

State Gaming Tax

According to the State Constitution, the Gaming Commission is responsible for setting the gaming tax rate within the limitation that “up to a maximum of 40 percent of the adjusted gross proceeds of limited gaming shall be paid by each licensee.” As of January 8, 2009, Amendment 50 to the Colorado Constitution requires statewide voter approval for any increases in the gaming tax rates above the July 1, 2008, levels. Statute (Section 12-47.1-601, C.R.S.) specifies the factors that the Gaming Commission shall consider in setting the tax rate, including the impact of gaming on the communities where casinos are located and on state agencies, the profitability of other forms of gambling, and the intent of the Gaming Act in encouraging growth and investment in the gaming industry. Statutes do not include the impact of the gaming tax rate on the General Fund as a factor the Gaming Commission must consider.

The Gaming Commission has established a graduated gaming tax schedule, in which casinos pay an increasing percentage tax rate as their annual adjusted gross proceeds from limited and extended gaming exceeds various thresholds. Annual adjusted gross proceeds is the total amount of all wagers made by casino patrons minus the total amount the casino pays patrons in winnings. As the following table shows, each casino paid 0.25 percent in taxes on the first \$2 million in adjusted gross proceeds earned in Fiscal Year 2011, plus 2 percent in taxes on the next \$3 million in adjusted gross proceeds earned, and so forth. The gaming tax rates as of June 2011, which were in effect for the period reviewed during this audit, are shown in the following table.

Colorado Gaming Tax Rates As of June 2011	
Tax Rate Percentage	Casino Annual Adjusted Gross Proceeds
0.25%	Up to and including \$2 million
2.00	More than \$2 million to \$5 million
9.00	More than \$5 million to \$8 million
11.00	More than \$8 million to \$10 million
16.00	More than \$10 million to \$13 million
20.00%	More than \$13 million

Source: Office of the State Auditor’s analysis of the Colorado Gaming Regulations.

Effective July 2011, the Gaming Commission reduced the gaming tax rates to between 0.2375 percent and 19 percent of casino annual adjusted gross proceeds.

Gaming Revenue, Distributions, and Expenditures

Since 1992, casinos have paid more than \$1.5 billion in gaming taxes to the State on \$11.4 billion in adjusted gross proceeds. Gaming tax revenue declined about 6 percent between Fiscal Years 2007 and 2011, but averaged about \$106 million per year over this period. Gaming tax revenue is used to help cover the costs of Gaming Commission and Division operations as well as provide funding to other state programs and entities, as stipulated in the Colorado Constitution and statutes. The Colorado Constitution requires the State to distribute gaming tax revenue to various state and local entities after Gaming Commission and Division expenses have been paid and 2 months of administrative expenses have been reserved. The Colorado Constitution also requires the Division to distinguish between gaming tax revenue collected from limited gaming and revenue collected from extended gaming and to distribute the proceeds from the two types of gaming differently. Statute (Section 12-47.1-701.5, C.R.S.) provides the allocation formula used to determine the portion of gaming tax revenue attributed to limited gaming and the portion attributed to extended gaming. The following table highlights the limited and extended gaming tax revenue distributions required by the State Constitution.

Limited and Extended Gaming Tax Distribution Requirements As of June 2011		
	Limited Gaming	Extended Gaming
Description	Revenue is derived from gaming taxes on casinos' annual adjusted gross proceeds resulting from limited gaming.	Revenue is derived from gaming taxes on casinos' annual adjusted gross proceeds resulting from extended gaming.
Tax Distributions	<ul style="list-style-type: none"> • 50 percent to the State's General Fund, which is distributed to other specified funds and programs, as directed by statute • 28 percent to the Colorado State Historical Fund • 12 percent to Gilpin and Teller Counties in proportion to the gaming revenue generated within each county • 10 percent to Cripple Creek, Black Hawk, and Central City in proportion to gaming revenue generated within each city 	<ul style="list-style-type: none"> • 78 percent to public community colleges, junior colleges, and local district colleges in proportion to their respective full-time-equivalent student enrollments • 12 percent to Gilpin and Teller Counties in proportion to the tax revenue paid by casinos within each county • 10 percent to Cripple Creek, Black Hawk, and Central City in proportion to the tax revenue paid by casinos within each city
Source: Office of the State Auditor's analysis of gaming tax distribution requirements in the Colorado Constitution.		

Per the Colorado Constitution, most of the gaming tax revenue is distributed in accordance with the previous table. In Fiscal Years 2007 through 2011, an average of about 89 percent of annual gaming tax revenue, or about \$97 million per year, was distributed to beneficiaries. Gaming tax dollars have been used to fund state historical restoration projects, higher education, regulation of the gaming industry, and the impacts to state and local governments caused by gaming. Fiscal Year 2010 was the first year the State collected and distributed gaming tax revenue attributable to extended gaming. The following table shows the limited and extended gaming tax revenue distributions made to beneficiaries for Fiscal Years 2007 through 2011.

Limited and Extended Gaming Distributions Fiscal Years 2007 Through 2011					
	2007	2008	2009	2010¹	2011¹
General Fund ²	\$53,178,000	\$50,296,000	\$42,641,000	\$44,406,000	\$43,205,000
State Historical Fund	29,780,000	28,166,000	23,879,000	24,867,000	24,195,000
Gaming Counties ³	12,763,000	12,071,000	10,234,000	11,609,000	11,439,000
Gaming Cities ⁴	10,636,000	10,059,000	8,528,000	9,674,000	9,533,000
Community College System	NA	NA	NA	6,186,000	6,955,000
Total	\$106,357,000	\$100,592,000	\$85,282,000	\$96,742,000	\$95,327,000
Source: Colorado Division of Gaming financial audits, Fiscal Years 2007 through 2010, and unaudited financial statements for Fiscal Year 2011.					
¹ Distributions for Fiscal Years 2010 and 2011 include limited and extended gaming tax revenue. Fiscal Year 2010 was the first year the State collected and distributed extended gaming tax revenue.					
² Recipients of General Fund monies from gaming taxes include the Department of Transportation; Travel and Tourism Promotion Fund; Local Government Limited Gaming Impact Fund; Colorado Council on the Arts Cash Fund; Colorado Film Commission; Office of Film, Television, and Media Cash Fund; New Jobs Initiative Cash Fund; Bioscience Discovery Evaluation Cash Fund; Innovative Higher Education Research Fund; and Creative Industries Cash Fund.					
³ Gaming counties include Gilpin and Teller.					
⁴ Gaming cities include Black Hawk, Central City, and Cripple Creek.					

The Division also collects revenue each year from licensing and background investigation fees, fines levied by the Gaming Commission and Division for gaming licensee noncompliance, and investment income, which is used to cover administrative costs, making the Division fully cash funded. In Fiscal Years 2007 through 2011, Division revenue from sources other than the gaming tax averaged about \$3 million annually, and the Division's operating expenditures averaged about \$7 million a year. In addition, the Division transfers an average of about \$3.8 million each year to other state agencies to address the impact of casino gaming on the State. State agencies that receive gaming funds include the Department of Local Affairs for historical grants, Department of Transportation

for highway maintenance near gaming cities, Colorado Bureau of Investigation for gaming criminal investigations, Colorado Division of Fire Safety for fire safety inspections of casinos, and Colorado State Patrol for patrolling highways near gaming cities.

Audit Purpose and Scope

This report provides the results of our performance audit of the Gaming Commission and the Division. The purpose of our audit was to evaluate the effectiveness of the Gaming Commission's and Division's regulatory and oversight activities. Specifically, the audit objectives were to determine whether:

- The Gaming Commission and the Division have adequate monitoring and oversight procedures to ensure casinos comply with regulatory standards intended to promote honesty, integrity, fairness, and competition in Colorado's gaming industry.
- The Division's revenue audits, compliance reviews, and enforcement actions are sufficient to gain assurance that controls are in place to ensure casinos properly report gaming revenue and accurately file gaming taxes.
- The Division has appropriate and reliable procedures to ensure that casinos comply with the Gambling Payment Intercept Act (Payment Intercept Act).

To accomplish our audit objectives, we reviewed the following areas: (1) Division and Gaming Commission processes for granting multiple retail licenses to casino ownership groups; (2) Division compliance reviews and revenue audits of casinos; (3) Division enforcement and administrative actions, which are corrective measures taken against licensees for noncompliance; and (4) Division processes for ensuring casinos comply with the Payment Intercept Act. The audit did not review the Division's regulation of gaming licenses for casino employees and equipment, the gaming tax structure, or Gaming Commission governance.

As part of our audit work, we collected and analyzed Division licensing, compliance, audit, and enforcement data and documentation. Audit work included a review of the licensing documentation, revenue, and gaming tax obligation for each of the 41 casinos operating in Colorado in Fiscal Year 2010; data maintained in five of the Division's data systems and tracking spreadsheets from July 2007 through December 2010; the results of the Fiscal Year 2010 compliance reviews and casino revenue audits conducted by the Division's Audit Section; and the results of each Payment Intercept Act compliance review conducted by the Division in Calendar Year 2010. Audit work also included a review of the following samples:

- Gambling Payment Intercept system search data and patron prize data for Calendar Year 2010 for a nonstatistical sample of three casinos in order to test the Division's controls related to the Payment Intercept Act. The three sampled casinos conducted about 1.5 percent of the searches of prize-winning patrons in the Gambling Payment Intercept system required by the Payment Intercept Act in Calendar Year 2010.
- Division records of administrative actions issued to a sample of 14 casinos by the Division from July 2007 through December 2010 to determine whether the Division had progressively taken action against casinos for noncompliance with gaming regulations and standards. We selected a nonstatistical sample to provide adequate coverage of both Division field offices. For five of the sampled casinos, we analyzed Division records for Calendar Years 2008 through 2010 to determine whether the Division had included the casinos' administrative actions in its casino background investigation reports and accurately reported the actions to the Gaming Commission for use in licensing renewal decisions. We selected the five casinos because some of their administrative actions were not accurately recorded in the Division's data systems.

We selected our samples to provide sufficient coverage of Division processes and controls for (1) implementing and enforcing the Payment Intercept Act, (2) issuing administrative actions progressively, and (3) documenting and reporting administrative actions taken against casinos, all of which were significant to the objectives of this audit. The results of these samples cannot be projected to the entire population of casinos. Our conclusions on the sufficiency of Division processes and controls are reflected in our findings.

In addition, we visited and interviewed staff and management at each of the Division's three offices in Golden, Central City, and Cripple Creek; observed Gaming Commission meetings and Division processes; and interviewed gaming officials in Louisiana, Michigan, Missouri, Nevada, and South Dakota to identify best practices in the gaming industry. According to the Division, these states have casino gaming oversight structures similar to Colorado.

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 state government. The audit work was performed from February through July 2011 and was conducted 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 the evidence obtained provides a reasonable basis for our findings, conclusions, and recommendations based on our audit objectives. We thank the Gaming

Commission, the Division, and the Department for their assistance and cooperation during the audit.

Summary of Findings

Overall, we found the Gaming Commission and Division have implemented a variety of policies and procedures to carry out their constitutional and statutory responsibilities to enforce gaming regulations, ensure casinos operate honestly and free from criminal and corruptive elements, and promote public confidence and trust in Colorado's gaming industry. At the same time, we identified several areas in which the Gaming Commission and Division can make improvements to strengthen their oversight of Colorado's casinos. Specifically, we found:

- The Gaming Commission's current tax and licensing structures allow owners of multiple attached casinos to gain a competitive advantage over owners of other casinos.
- The efficiency of the Division's methods for tracking casino oversight activities can be improved. The Division's data systems contain inaccurate, incomplete, and overlapping data that can limit the Division's ability to utilize its data and produce accurate reports of its regulatory activities for the Gaming Commission and Division management.
- The Division's Audit Section did not conduct the compliance reviews and audits of some casinos necessary to ensure coverage of all internal control areas or gain assurance that all casinos were reporting revenue accurately.
- The Division's method for determining casino compliance with the Payment Intercept Act does not provide consistent and reliable results or ensure timely compliance with the Payment Intercept Act.
- The Division has not consistently applied progressive administrative actions for casinos that do not comply with required minimum internal controls as a means to motivate casinos to improve compliance.

We discuss these issues and our recommendations in the remainder of this report.

Issuing Multiple Licenses to Casino Owners

According to the Gaming Act (Section 12-47.1-501, C.R.S.), a retail casino gaming license is required for all individuals who conduct gaming on their premises. To obtain a retail license to operate a casino, applicants must apply to the Division and provide their licensing history; details of their business, such as the articles of incorporation, annual reports, owners, and officers; the scale and location of their building; and a floor plan of each floor on which gaming will be conducted. The Division conducts background and financial investigations of each retail license applicant and presents the results of the investigations to the Gaming Commission for license approval or denial. The Gaming Commission licenses each casino separately, although some casinos are operated by the same owner; share resources, such as staff and a single surveillance room; and are physically attached, meaning a patron may walk from one casino to the other without leaving the building structure. The Gaming Act (Section 12-47.1-808, C.R.S.) prohibits individuals from holding “an ownership interest in more than three [gaming] retail licenses,” or casinos. According to our review of the Gaming Act and interviews with gaming industry officials, the original intent of the statute was to limit the number of licenses that an owner could hold in order to prevent a single owner from dominating the industry or having a significant advantage over other owners.

As discussed previously, the Gaming Act (Section 12-47.1-601, C.R.S.) requires the State to tax casinos on their adjusted gross proceeds, which is the total amount of all wagers made by casino patrons minus the total amount the casino pays patrons in winnings. The Gaming Commission has established a graduated gaming tax structure, which ranged from 0.25 percent to 20 percent for the time period we tested, based on a casino’s annual adjusted gross proceeds for limited and extended gaming. Casinos pay a higher percentage rate as their annual adjusted gross proceeds exceeds various thresholds.

In Fiscal Year 2010, there were 26 different ownership groups that operated 41 casinos in Colorado. Eleven of the ownership groups in the state operated multiple casinos. Of those 11 ownership groups with multiple casinos, five ownership groups owned multiple casinos that were physically attached, as shown in the following table.

Comparison of Casino Owners and Casinos in Operation Fiscal Year 2010			
Number of ownership groups with multiple licenses for attached casinos	5	Number of attached casinos	11
		Number of unattached casinos	2
Number of ownership groups with multiple licenses without attached casinos	6	Number of unattached casinos	13
Number of ownership groups with single licenses	15	Number of unattached casinos	15
Totals	26		41
Source: Office of the State Auditor's analysis of Division of Gaming information.			

What audit work was performed and what was the purpose?

We reviewed the adjusted gross proceeds and tax payment data for each of the 41 casinos operating in Fiscal Year 2010, as well as licensing documentation for each of the five ownership groups that held multiple licenses for casinos that were physically attached in Fiscal Year 2010. We compared the tax liability of the five ownership groups operating multiple physically attached casinos with the tax liability of ownership groups that operate casinos that are not attached to determine whether owning multiple attached casinos provides a tax advantage. We also performed this comparison to determine whether the current gaming tax structure and practice of issuing separate licenses for physically attached casinos owned by a single ownership group provide an equitable taxation structure among different types and sizes of casinos. We also interviewed industry stakeholders, former Division staff, and Division management to analyze the graduated gaming tax structure and determine the reasons that ownership groups obtain and the Gaming Commission issues multiple licenses.

How were the results of the audit work measured?

According to statute (Section 12-47.1-102, C.R.S.), one of the reasons for regulating and licensing the gaming industry is "to preserve the economy and policies of free competition" among casinos in Colorado. Establishing a tax structure and tax rates that are equitable and fair for different types and sizes of casinos is an important part of ensuring that casinos can compete freely. According to the former Executive Director of the Department of Revenue, who administered the Department at the time the gaming tax structure was first implemented, the Gaming Commission established a graduated tax structure to

lower the tax burden on smaller-revenue casinos and foster competition with the higher-revenue-generating casinos.

The provisions of the Gaming Act indicate that the Gaming Commission has a responsibility to represent the State's interests while balancing the interests of the gaming industry. Specifically, statute (Section 12-47.1-601, C.R.S.) requires that, in setting the gaming tax, the Gaming Commission consider the impact of gaming on the communities where gaming is located and affected state agencies as well as the impact on the profitability of the gaming industry. Statute (Section 12-47.1-302, C.R.S.) also requires the Gaming Commission to report to elected officials "any laws which it determines require immediate amendment to prevent abuses and violations of [the Gaming Act] or any rule or regulation promulgated pursuant to [the Gaming Act] or to remedy undesirable conditions in connection with the administration or operation of the Division or [Colorado] gaming."

What problem did the audit work identify and why does this problem matter?

As noted previously, the Gaming Act (Section 12-47.1-808, C.R.S.) prohibits individuals from holding "an ownership interest in more than three [casino gaming] retail licenses." We found that the Gaming Commission has issued up to three retail licenses to some casino owners. We also found that permitting owners to obtain up to three licenses for adjoined casinos, combined with the current graduated gaming tax structure, provides a tax advantage for some casinos that may be counter to the statutory requirement that gaming be conducted competitively [Section 12-47.1-102(1)(a), C.R.S.]. Specifically, ownership groups that have obtained multiple licenses to operate physically attached casinos—meaning patrons can walk from one casino to the other without leaving the building—have realized a gaming tax advantage over other ownership groups. Because Colorado's gaming tax is assessed on the adjusted gross proceeds collected under each retail license, obtaining multiple licenses for physically attached casinos results in the casino owner paying a lower amount of gaming taxes than if the owner held a single retail license for the entire adjoined gaming space. Obtaining multiple licenses in order to pay a lower gaming tax is not specifically prohibited by statute. In addition, these owners are not prohibited by gaming rules or policies from sharing resources, such as staff and surveillance facilities, which could reduce the operating costs of the attached casinos in addition to minimizing the tax burden, and further encourage owners to seek multiple licenses for adjoined casinos. Under required minimum internal controls, each licensed casino must have a cashier cage and manager.

We found the practice of holding multiple licenses for attached casinos has occurred most frequently in the gaming town of Cripple Creek, where nine out of the 11 multiple licensed attached casinos operate. The other two are located in

Black Hawk. We estimate that the five owners with multiple licenses and attached casinos in Colorado paid about \$4.9 million less in gaming taxes to the State in Fiscal Year 2010 than they would have if they had operated the attached casinos under one casino retail license or if their attached casinos had been taxed under one license. For Fiscal Years 2008 through 2010, we estimated that the five owners paid a combined total of about \$14.1 million less in gaming taxes to the State.

Because individual casinos' adjusted gross proceeds and gaming tax payments are proprietary business information, we provide a hypothetical example, rather than identifying actual casinos, to demonstrate the inequity created by the current licensing policy and graduated gaming tax structure. In the following table, Casino A is a licensed casino owned by Owner #1. Casinos B and C are owned by Owner #2 and are physically attached. The following table shows the annual adjusted gross proceeds collected for each owner, the associated gaming tax rate, and the annual gaming taxes each owner owes the State.

Example Comparison of Gaming Taxes For Casino Owners With One License Versus Multiple Licenses			
	Annual Adjusted Gross Proceeds	Tax Rate¹	Annual Gaming Taxes
Owner #1			
Casino A			
\$0 to \$2 million	\$ 2,000,000	0.25%	\$ 5,000
\$2 to \$5 million	3,000,000	2.00	60,000
\$5 to \$8 million	3,000,000	9.00	270,000
\$8 to \$10 million	2,000,000	11.00	220,000
\$10 to \$13 million	3,000,000	16.00	480,000
\$13 million and up	1,000,000	20.00	200,000
Total for Owner #1	\$14,000,000	-	\$1,235,000
Owner #2			
Casino B (attached to Casino C)			
\$0 to \$2 million	\$ 2,000,000	0.25%	\$ 5,000
\$2 to \$5 million	3,000,000	2.00	60,000
\$5 to \$8 million	2,000,000	9.00	180,000
Casino B Total	\$ 7,000,000	-	\$ 245,000
Casino C (attached to Casino B)			
\$0 to \$2 million	\$ 2,000,000	0.25%	\$ 5,000
\$2 to \$5 million	3,000,000	2.00	60,000
\$5 to \$8 million	2,000,000	9.00	180,000
Casino C Total	\$ 7,000,000	-	\$ 245,000
Total for Owner #2	\$14,000,000	-	\$ 490,000
Tax Advantage for Owner #2 Over Owner #1	-	-	\$ 745,000
Source: Office of the State Auditor's analysis of the differences in tax liability for casinos in a hypothetical situation.			
¹ Taxes were calculated based on the rates in effect as of June 30, 2011.			

In the example above, the difference of \$745,000 in tax liability creates a competitive advantage for Owner #2 compared to Owner #1. This tax advantage is unfair if the operating costs for the attached Casinos B and C are equivalent to or less than the operating costs for Casino A. If the total adjusted gross proceeds for Owner #2's attached casinos were taxed collectively, the owner would have fallen into the higher tax bracket. The current licensing policy and gaming tax on each licensee's adjusted gross proceeds favor owners with multiple casino licenses by reducing the amount of taxes they pay to the State. As a result, Gaming Commission policies and practices have not ensured the application of

the gaming tax provides a fair and competitive environment in the gaming industry.

Additionally, one of the purposes of establishing both limited and extended gaming in Colorado was to generate revenue for the State Historical Fund, the gaming cities and counties, and public community colleges. Therefore, the tax savings casino owners gain by operating multiple attached casinos also negatively impact gaming tax revenue that is used to help fund these beneficiaries.

Why did the problem occur?

We found that a combination of two factors, the Gaming Commission's licensing policy and the gaming tax structure, have led to a gaming tax advantage for some casino owners. First, the Gaming Commission has not prohibited ownership groups from obtaining multiple casino licenses that will result in reducing the owners' gaming tax obligation to the State. For example, the Gaming Commission has not implemented requirements for each licensed casino to operate independently within its own building and does not consider factors, such as whether the license is for a building attached to an existing casino or is part of an existing casino, when it issues an additional casino license to an owner. In fact, the Gaming Commission's current policies and rules would not prevent the owner of one large casino from seeking up to three licenses on that casino to reduce the tax liability. According to the Division, statute (Section 12-47.1-808, C.R.S.) permits owners to obtain three casino licenses without restrictions. However, we believe the Gaming Commission has the authority to implement gaming rules, policies, and procedures prohibiting casino owners from obtaining additional casino licenses that will result in a tax advantage over other owners. Specifically, Section 12-47.1-302, C.R.S., states that the rules and regulations promulgated by the Gaming Commission shall include "the requirements, qualifications, and grounds for the issuance...of all types of...licenses required for the conduct of limited gaming," "restrictions upon the times, places, and structures where limited gaming shall be authorized," and "procedures for determining the suitability or unsuitability of persons, acts, or practices [for gaming]." In accordance with the statutes, the Gaming Commission has established regulations relating to the safety, accessibility, floor plans, and lease agreements for the buildings where gaming is to take place. Nonetheless, the Gaming Commission has not developed policies or rules to prevent owners with multiple licenses for attached casinos from receiving a gaming tax advantage over other owners. Requiring that each licensed casino be physically separate from any other casino (i.e., meaning it is not possible to walk from one casino to another without leaving the building) would prevent owners from obtaining multiple licenses for attached casinos. Requiring that each licensed casino operate with separate staff, surveillance systems, and gaming equipment would reduce the financial incentive for owners to seek multiple licenses for attached casinos in order to reduce their tax liability.

In addition, the Gaming Commission has not modified the gaming tax structure to ensure the graduated gaming tax is applied equitably and in a manner that does not provide particular ownership groups, such as those operating multiple attached casinos, a tax advantage compared to other ownership groups. According to Division management, on two separate occasions past Gaming Commissions reviewed casino owners reducing their gaming tax by obtaining multiple licenses. On both occasions, past Gaming Commissions concluded that no rule clarification or statutory change was needed. However, we believe the Gaming Commission has the responsibility to clarify statute through rules and regulations when practices render the gaming tax structure inequitable and reduce competition among casinos. Implementing a rule to modify the gaming tax structure, such as implementing a flat gaming tax or applying the graduated gaming tax to the total or aggregated adjusted gross proceeds of an owner's adjoined casinos rather than applying the tax to the adjusted gross proceeds of each licensed casino, would eliminate the gaming tax advantage for some casino owners.

The Gaming Commission is in a unique position to address the inequity in the application of the gaming tax created by the licensing policy and gaming tax structure. Options the Gaming Commission should consider to address this problem include, but are not limited to, the following:

- Expanding the current requirements for licensed casino facilities, including requiring each licensed casino to operate independently of and physically separate from (i.e., meaning it is not possible to walk from one casino to another without leaving the building) adjoining casinos.
- Implementing a policy to prevent ownership groups from obtaining additional licenses in order to divide or expand an existing casino's operations.
- Aggregating the total adjusted gross proceeds of commonly owned adjoined licensed casinos for the purpose of applying the gaming tax, instead of taxing the adjusted gross proceeds of each licensed casino separately.
- Implementing a rule to revise the gaming tax structure in other ways, such as by implementing a flat gaming tax in place of a graduated tax.

According to the Division and Gaming Commission, the Gaming Commission intends to hold public hearings to discuss this issue. When weighing its options, the Gaming Commission should assess the impact that implementing each option will have on the gaming industry, gaming communities, and the State. The Gaming Commission should also ensure it implements the approach that best

fulfills legislative intent to provide fairness and preserve free competition while balancing the State's interests with the interests of the gaming industry.

Recommendation No. 1:

The Colorado Limited Gaming Control Commission (the Gaming Commission) should evaluate the options to eliminate the financial tax advantages gained by ownership groups with multiple physically attached casinos and implement the most feasible option for ensuring a fair and competitive environment for the gaming industry in Colorado.

Limited Gaming Control Commission Response:

Partially agree. Implementation date: July 2012.

The Gaming Commission agrees that this issue warrants further examination. However, the Gaming Commission has not yet examined this matter or reached any conclusions as to whether any changes are warranted. As is reflected in this report, the Gaming Commission has scheduled a rulemaking hearing to fully examine this issue. If the Gaming Commission determines that any changes need to be made, it will consider options to address this matter. Options may include promulgating changes to Colorado Gaming Regulations, recommending statutory changes, a combination of the two, or no changes at all. This is a complex issue that will require the Gaming Commission to consider many factors and testimony from all interested parties. Should the Gaming Commission find any laws that it determines require immediate amendment, it will report such findings to the appropriate parties, pursuant to Section 12-47.1-302(1)(f), C.R.S.

Data Systems and Management

The Division's Licensing, Investigations, Audit, and Field Operations Sections conduct a range of regulatory activities, including processing license applications for casinos, employees, and equipment manufacturers; conducting compliance reviews and audits to ensure casinos comply with statutes, regulations, and required minimum internal controls; and issuing administrative actions against the casinos for noncompliance. The Division reports its activities and findings to the Gaming Commission. In order to record its regulatory activities and track casino compliance with state laws and regulations, the Division maintains the following data systems and spreadsheets:

- **Case Reporting System.** This is the primary system used to store each Division section's compliance review case reports and related administrative actions. The case reports contain the work completed by staff when conducting each compliance review. The Division uses the system on a regular basis to create informational reports for Division management and the Gaming Commission about the Division's regulatory activities and for gaming license renewal purposes.
- **Compliance Review Tracker Spreadsheets.** The Division tracks each section's compliance reviews and associated findings in tracking spreadsheets separate from the Case Reporting System. The Division has created an individual tracking spreadsheet for each casino. The Division uses the information to schedule compliance reviews, assess Division staff activity, verify the reviews completed by staff, and track noncompliance identified during the reviews.
- **Licensing System.** The Division uses this system to record and monitor licensing activities, administrative actions issued to licensees by each of the Division's sections, and license expiration dates. The Division also uses this information, along with information from the Case Reporting System, to prepare gaming license renewal reports for the Gaming Commission.
- **Field Operations Administrative Action Tracker.** The Division's Field Operations Section maintains a spreadsheet separately from the Division's Case Reporting and Licensing Systems to track the administrative actions the Field Operations Section issues against licensees for noncompliance.
- **Gaming Commission Administrative Action Tracker.** The Division maintains a spreadsheet of administrative actions issued by the Gaming Commission and the Division separately from the Case Reporting and Licensing Systems to track the actions taken against licensees.

What audit work was performed and what was the purpose?

We reviewed the Division's data systems, spreadsheets, and data management processes and interviewed Division management and staff to determine the purpose of each system and spreadsheet, whether the data contained in each were appropriate and sufficient for the purpose identified, and whether the Division's practice of maintaining multiple systems with overlapping data was efficient and effective. Specifically, we reviewed data tracked from July 2007 through December 2010 in each of the five data systems and spreadsheets listed above and interviewed staff from the Division's Licensing, Audit, Investigations, and Field

Operations Sections. We compared administrative action and compliance review data from each of the above systems and spreadsheets to determine whether the systems or spreadsheets contained complete and accurate information. We also examined the accuracy of each system and spreadsheet by reviewing the formulas contained in the system or spreadsheet.

How were the results of the audit work measured?

The Division is responsible for regulating and supervising limited gaming in Colorado (Section 12-47.1-202, C.R.S.) and is required to report the results of its reviews, audits, and investigations to the Gaming Commission [Section 47.1-1608(2), 1 C.C.R., 207-1]. To carry out its responsibilities, the Division needs complete, accurate, and consistently recorded data to monitor licensees and report the effectiveness of its regulatory activities. For example, the Division needs reliable data on license renewals and expirations, casino compliance with revenue reporting and internal control requirements, and administrative actions. The U.S. Government Accountability Office defines data completeness as the extent to which relevant records are present and the fields in each record are populated appropriately based on the intended purpose of the data and system.

What problem did the audit work identify?

Overall, we found problems with the completeness and accuracy of the Division's data in three of the Division's five data systems used to monitor the gaming industry and track and report on compliance with Division regulations. These issues are described below.

Incomplete Data. We found the Division did not consistently maintain complete records of its administrative actions and the results of its compliance reviews of casinos. Specifically:

- We found that 45 percent (37 out of 82) of the administrative actions issued from July 2009 through December 2010 for noncompliance were not recorded as administrative actions in the Division's Case Reporting System. We also identified four administrative actions that were not entered in the Case Reporting System. Both of these problems resulted in an incomplete list of administrative actions in the Case Reporting System. Incomplete data in the Case Reporting System can result in the misreporting of information to the Gaming Commission and Division management.
- We identified 47 administrative actions issued between July 2009 and December 2010 for casino noncompliance with required minimum internal controls that were not entered in the Field Operations Section's

Administrative Action Tracker, resulting in an incomplete list of administrative actions. Tracking incomplete data in the Field Operations Section's spreadsheet is inefficient and can result in staff not considering past administrative actions when performing compliance reviews.

- We identified 28 compliance reviews completed in Fiscal Year 2010 that were not documented in nine of the 41 casinos' Compliance Review Tracker Spreadsheets, resulting in an incomplete list of completed compliance reviews. Incomplete information in the Compliance Review Tracker Spreadsheets hinders staff's ability to efficiently use the spreadsheets as intended.

Inaccurate Data. We found Division staff did not always record or classify their regulatory activities accurately into the Compliance Review Tracker Spreadsheets. Specifically:

- We identified formula errors in 10 percent (four out of 41) of the Fiscal Year 2010 Compliance Review Tracker Spreadsheets, resulting in overstated percentages for the number of Division compliance reviews completed at some casinos and understated percentages for others.
- We identified extraneous data that had been incorrectly counted by the automated spreadsheet as completed compliance reviews in 46 percent (19 out of 41) of the Fiscal Year 2010 Compliance Review Tracker Spreadsheets, resulting in an overstatement of the number of compliance reviews the Division had completed. For example, when Division staff entered their initials into cells that should have remained blank, the initials were incorrectly counted by the Division's spreadsheet formula as completed compliance reviews.

Inaccurate data in the Compliance Review Tracker Spreadsheets may result in the Division's mistakenly believing compliance reviews have been completed when they have not, scheduling repetitive or unnecessary compliance reviews, and inaccurately assessing the activities performed by staff.

Why did the problem occur?

The Division has not consistently maintained complete or accurate data for the following reasons:

- The Division has not developed written policies and procedures that define and communicate to staff (1) the purpose of each data system, (2) what data should be entered in each system, (3) which staff are responsible for entering data into each system, and (4) the proper method for entering

data. Without a clear purpose and guidelines for data entry, staff reported to us that they are uncertain what data should be entered into the systems, which results in staff not entering data completely or consistently. For example, Division staff in different sections and field offices are inconsistent in how they record findings in the Compliance Review Tracker Spreadsheets. Specifically, staff at one field office signify findings using red text, while staff in the other field office use a character sign to indicate findings. Additionally, some staff do not record findings in the Compliance Review Tracker Spreadsheets.

- The Division has implemented these various systems over time without evaluating the potential for duplication and the risk of inaccuracy. For example, various administrative actions are recorded in four different systems: the Case Reporting System, the Licensing System, the Field Operations Administrative Action Tracker, and the Gaming Commission Administrative Action Tracker. Staff must therefore enter the same data into multiple systems, increasing the risk of data being entered inaccurately or not being entered in all systems.
- While some supervisors review the content of cases entered in the Case Reporting System, the Division has not established policies or procedures for supervisors to conduct consistent reviews of key data in order to verify their accuracy and completeness. Because it does not require supervisory review, the Division may not identify and correct instances of inaccurate and incomplete data.

Why does this problem matter?

Incomplete and inaccurate data prevent the Division from properly analyzing compliance reviews and administrative actions to identify problem areas and casinos, ensure consistent regulation, monitor staff, and allocate resources efficiently for its regulatory activities. For example, as discussed previously, errors in the Compliance Review Tracker Spreadsheets may result in the Division's mistakenly believing compliance reviews have been completed when they have not, which could result in missed opportunities to correct casino noncompliance with required minimum internal controls. In addition, maintaining unreliable data in the Case Reporting System can result in staff reporting unreliable information to the Gaming Commission, Division management, and other stakeholders. For example, administrative actions tracked in the Case Reporting System are reported to and considered by the Gaming Commission as part of the casinos' licensing renewal process. Incorrect coding in the Case Reporting System has resulted in Division management not reporting some administrative actions to the Gaming Commission. During our review of data entered in Calendar Years 2008 through 2010, we identified five administrative

actions that were warning letters issued to casinos for noncompliance that the Division had omitted from four licensee background investigation reports provided to the Gaming Commission when it made the decision to renew the casinos' licenses. According to the Division, the omitted administrative actions would not have impacted the Gaming Commission's decision to renew the casinos' licenses. Nonetheless, the Gaming Commission should be fully informed of the casinos' regulatory history when making renewal decisions. Additionally, we found that in Fiscal Year 2010, the Division slightly overstated the number of compliance reviews it completed when it reported its regulatory activities to the Gaming Commission because of inaccurate and incomplete data we identified in the Case Reporting System. Providing accurate information on the Division's regulatory activities to the Gaming Commission is important because the Gaming Commission uses the information to hold the Division accountable and ensure it is meeting its oversight responsibilities.

Finally, due to the existence of multiple, overlapping databases and spreadsheets, Division staff must compare and verify information across the various systems, as well as enter the same information into multiple systems. For example, staff must check three systems to ensure that all administrative actions are reported to the Gaming Commission. Entering and searching for the same data in several databases is an inefficient use of staff time.

Recommendation No. 2:

The Division of Gaming (the Division) should implement an efficient method that ensures accurate and complete data in order to track its regulatory activities and uses Division staff time efficiently by:

- a. Determining the purpose and need for each of its data systems and eliminating unnecessary and duplicative systems.
- b. Standardizing procedures for data entry and training all staff and supervisors on the data entry procedures.
- c. Requiring that supervisors conduct regular reviews of data to ensure that cases are coded correctly and case information is complete.

Division of Gaming Response:

Agree. Implementation date: September 2012.

- a. The Division will examine each of our data systems and their purposes. Based on the Division's operational needs, a determination

will be made as to what changes in both procedures and data systems are necessary to ensure the most efficient and accurate means of collecting information. The Division plans to upgrade its licensing system software by the end of the fiscal year. However, the timing of this software upgrade is dependent upon external factors outside of the Division's control. A preliminary study of the new software has revealed potential components that the Division believes may assist in the consolidation of data systems and the elimination of duplication.

- b. The Division will revise existing procedures and develop new procedures in concert with our analysis of data systems, as discussed in part a. Additionally, the Division will incorporate such changes into a training program for all employees who utilize these data systems.
- c. The Division will implement this requirement immediately for the case reporting system. All reports generated in the case reporting system will require review and approval by the assigned supervisor. A monthly management report has been developed to ensure that all case reports have been approved by a supervisor. This report will be reviewed by Division management and disseminated to supervisors. We will incorporate these same requirements into our procedures developed following an analysis of our data systems, as discussed in parts a and b. Ultimately, the software upgrade to the Division's Licensing System will be evaluated to determine if data systems can be consolidated and supervisory reviews documented in this system.

Casino Monitoring and Enforcement

The Gaming Commission and Division are responsible for regulating the gaming industry in Colorado to ensure that gaming is conducted honestly, competitively, and in a manner that maintains public trust. To ensure the integrity of gaming in the state, according to statute (Section 12-47.1-302, C.R.S.), one of the Gaming Commission's duties is to establish internal control procedures for casinos, including accounting and reporting procedures and personnel policies. The Gaming Commission has delegated this duty to the Division, which has implemented a set of required minimum internal controls for casinos. In order to ensure that casinos have these controls in place, the Division conducts regular compliance reviews of the casinos. The Division also conducts revenue audits and external audit reviews to ensure that casinos are reporting their adjusted gross proceeds properly and paying their gaming taxes accurately. The Division's compliance reviews and audits are discussed further in Recommendation No. 3. The Division also conducts an annual review of casinos' compliance with the

requirements of the Payment Intercept Act, which is discussed in Recommendation No. 4. When the Division identifies problems during the reviews or audits, the Division and the Gaming Commission can sanction casinos based on the severity and frequency of the problem identified. The Division's sanctions, known as disciplinary and administrative actions, are discussed further in the final section of this report, Recommendation No. 5.

Compliance Review and Revenue Audit Coverage

The Division's Audit Section conducts compliance reviews periodically to ensure casinos have required minimum internal controls in place. Altogether, there are 60 different types of compliance reviews, grouped into nine review areas, that the Audit Section can conduct for casinos, as shown in the following table.

Division of Gaming Audit Section Compliance Reviews		
Review Area	Number of Review Types	Descriptions of Reviews
Accounting	16	Review a variety of accounting activities, forms, documentation, and controls related to revenue reporting and ensure adequate funds are on hand.
Automated Key Control System	8	Review controls at casinos that have an automated, electronic system to safeguard keys to restricted areas and ensure employee access to keys is appropriate.
Cage	7	Review the operation of the cage, which is where assets are collected, counted, and stored, to ensure proper counting of funds, validation of tickets, safeguarding of assets, and recordkeeping.
Kiosk Ticket Machines	6	Review the collection, handling, and counting of funds and tickets used in place of cash to play gaming machines from kiosks, which are machines that allow patrons to convert tickets to cash or vice-versa, and the transfer of those funds to the cashier.
Manual Key Control System	6	Review controls for casinos that have a manual, nonelectronic system to safeguard keys in restricted areas and ensure employee access to keys is appropriate.
Slot Machines	3	Review whether jackpots are processed correctly and variances between the amount of assets reported and the actual amount in the machine are properly investigated.
Slot Machine Drop and Count	7	Review the collection, handling, counting, and recording of revenue collected from slot machines and the transfer of those funds to the cashier.
Table Games	6	Review the collection, handling, and counting of revenue from table games, such as blackjack and poker, and the transfer of those funds to the cashier.
Miscellaneous	1	Ensure that any casino internal controls that vary from the minimum internal control requirements are necessary, have been approved by the Division, and have been properly implemented.
Total Number of Review Types	60	

Source: Office of the State Auditor's analysis of Division of Gaming policies and data on compliance reviews.

Not all of the above compliance reviews are applicable at every casino. For example, the Audit Section does not perform reviews related to table games at casinos that do not have table games. In addition, certain compliance reviews related to casino accounting are considered higher risk than others. Specifically, the Division considers four of the 16 accounting compliance reviews to be particularly high risk. These four highest-risk accounting compliance reviews can take the place of a revenue audit, discussed below, if the Division does not have the resources available to perform a revenue audit. In Fiscal Year 2010, the Audit

Section's two field offices in Cripple Creek and Central City completed a total of 2,358 compliance reviews. Of these 2,358 reviews, 201 reviews (9 percent) identified problems with casino internal controls.

Revenue audits of casinos are conducted periodically by the Audit Section to determine whether the casinos have accurately reported revenue to the Division. During a revenue audit, Division staff review and analyze casino records and reports on adjusted gross proceeds to identify anomalies or inconsistencies that would indicate an error in reporting. Gaming taxes are calculated as a percentage of a casino's adjusted gross proceeds, so accurate reporting is critical to ensure casinos pay the appropriate amount in taxes to the State. During Fiscal Year 2010, the Audit Section completed 11 revenue audits—one each at 11 of the 41 casinos in operation during that year. The Audit Section also reviews the external audits of casinos—which are required for casinos with \$10 million or more in annual adjusted gross proceeds, although some casinos with less adjusted gross proceeds have them done as well—to determine whether the external auditors identified any issues or inaccuracies in the revenue casinos reported. In Fiscal Year 2010, the Division reviewed external audits for 27 casinos. This review of the external audits is intended to provide the Division with added assurance that the highest-grossing casinos are accurately reporting their revenue and proceeds; these reviews are not intended to take the place of the Division's revenue audits or compliance reviews of the four high-risk accounting areas, both of which include detailed procedures to verify a casino's accounting and recording of revenue.

When the Audit Section identifies a problem during a compliance review, revenue audit, or review of an external audit, the Division requires the casino to correct the problem and may issue the casino an administrative action, which is a corrective action issued for noncompliance, depending upon the cause and severity of the problem identified. Administrative actions are discussed further in Recommendation No. 5.

What audit work was performed and what was the purpose?

We reviewed the Audit Section's compliance review, revenue audit, and external audit review coverage by examining compliance review data for Fiscal Year 2010 from the Compliance Review Tracker Spreadsheets, discussed in Recommendation No. 2; reviewing the number of revenue audits conducted and the casinos at which they were conducted; and interviewing Division staff. Specifically, we compared the number of compliance reviews completed and the review areas covered at each casino with Division coverage goals and expectations. In addition, we reviewed data to determine the number of casinos that received either a revenue audit or the four highest-risk accounting compliance reviews in Fiscal Year 2010. Finally, we interviewed Division staff regarding the

Audit Section's process for scheduling and conducting compliance reviews and revenue audits. The purpose of our audit work was to determine whether the Division ensures adequate oversight and coverage of casinos through its compliance reviews and revenue audits.

How were the results of the audit work measured?

The Division is responsible for regulating casinos to ensure the integrity of gaming in Colorado. The Code of Colorado Regulations [Section 47.1-1608(1)(g), 1 C.C.R., 207-1], which codifies Gaming Commission rules, requires the Division to investigate casino compliance with minimum internal controls, as directed by the Division Director. The Division Director has delegated responsibility for conducting compliance reviews and revenue audits to the Audit Section. According to Division staff, the Audit Section's goals for Fiscal Year 2010 were to complete a total of 1,275 compliance reviews at casinos, as well as to complete either a revenue audit or the four highest-risk accounting compliance reviews at each casino annually. We measured the Audit Section's activities against the Audit Section's goals.

The Audit Section's strategic plan states that the section will "evaluate [the] results of compliance [reviews]...to determine the level of compliance and risk associated with the casino." Additionally, the plan specifies that the Audit Section will work with the other Division sections to ensure no duplication of efforts and that all high-risk review areas are adequately addressed. As a best practice, the Audit Section should utilize the results of its reviews to implement more frequent reviews at the casinos with recurring or significant noncompliance, such as noncompliance in the highest risk areas.

What problem did the audit work identify?

Overall, we found the Audit Section did not conduct compliance reviews and audits of some casinos necessary to ensure coverage of all internal control areas or gain assurance that all casinos were reporting revenue accurately. Specifically, we found:

- There were no casinos at which the Audit Section completed all applicable compliance reviews. In Fiscal Year 2010, the Audit Section completed more than 2,300 compliance reviews, exceeding the Audit Section goal of 1,275 reviews by about 85 percent, but did so without a centralized plan or schedule. We found that the Audit Section repeated compliance reviews of the same area at some casinos, without regard for risk, rather than performing each of the applicable compliance reviews at each casino. For example, the Audit Section performed 18 manual key control system compliance reviews at one casino in Fiscal Year 2010, repeating each of

the six compliance reviews three times. However, at the same casino, the Audit Section did not conduct 10 of the 15 applicable accounting compliance reviews in Fiscal Year 2010. According to the Division, some compliance reviews were repeated in order to train new staff. However, staff time may have been used more effectively by completing a full set of accounting compliance reviews before repeating the manual key control system compliance reviews.

- The Audit Section did not meet its goal of completing either a revenue audit or the four highest-risk accounting compliance reviews at every casino in Fiscal Year 2010. Specifically, 10 (24 percent) of the 41 casinos operating during Fiscal Year 2010 did not receive a revenue audit *or* compliance review of the highest-risk accounting areas by the Audit Section. According to the Division, five of these 10 casinos underwent an external audit of their financial statements, which may provide some additional assurance but does not take the place of a revenue audit or compliance review of the highest-risk accounting areas conducted by the Division.

Why did the problem occur?

The Audit Section did not schedule compliance reviews and revenue audits in a manner that would provide coverage. As a result, the Audit Section did not conduct compliance reviews and revenue audits necessary to ensure coverage of all internal control areas, including the high-risk areas, at some casinos. Additionally, the Audit Section did not meet its goal of completing a revenue audit or the four highest-risk accounting compliance reviews at each casino because it does not have a process to ensure it completes specific compliance review areas, revenue audits, and the highest-risk compliance reviews.

The Division should ensure the Audit Section is using its resources efficiently and completing the reviews and audits needed to meet its regulatory oversight duties. Based on our evaluation, we believe the Audit Section currently has the ability to complete all applicable compliance reviews, including the high-risk reviews, at each casino annually. The Audit Section was able to complete 2,358 compliance reviews in Fiscal Year 2010, almost double its goal of 1,275 compliance reviews, and 528 more compliance reviews than if it had completed one of each compliance review at each casino. However, if the Division Director and Audit Section determine that staff resources are not sufficient to complete all applicable compliance reviews at each casino in addition to a revenue audit or the four highest-risk accounting compliance reviews, the Audit Section should develop a risk-based approach to completing its compliance reviews. The Audit Section should also develop a risk-based approach if staff are available to repeat compliance reviews that have already been completed.

One factor that the Audit Section could consider in a risk-based approach is the number of past problems identified in each compliance review area. The table below shows our analysis of the Audit Section's Fiscal Year 2010 compliance reviews and the problems identified.

Division of Gaming Audit Section Compliance Reviews Completed and Problems Identified by Review Area Fiscal Year 2010				
Review Area	Number of Reviews Completed	Percentage of Total Reviews Completed	Number of Reviews With Identified Problems	Percentage of Total Reviews With Identified Problems
Accounting	357	15%	83	41%
Slot Machine Drop and Count	333	14	30	15
Cage	600	25	28	14
Automated Key Control System	255	11	20	10
Manual Key Control System	347	15	15	7
Table Games	206	9	13	6
Kiosk Ticket Machines	210	9	11	6
Slot Machines	22	1	1	1
Miscellaneous	28	1	0	0
Total	2,358	100%	201	100%
Source: Office of the State Auditor's analysis of Division of Gaming compliance review data.				

Based on the numbers above, in Fiscal Year 2010 the Audit Section conducted proportionately too few reviews in the accounting area based on the number of problems it had identified. About 41 percent of the total problems the Audit Section identified were in the accounting area, but only 15 percent of the compliance reviews completed by the section were in the accounting area. If the Audit Section implemented a risk-based approach to conducting compliance reviews that accounted for the number of past problems identified, the Audit Section would need to increase the number of accounting compliance reviews it conducts for the next year.

Why does this problem matter?

It is important that the Division implement a process for planning, scheduling, and conducting compliance reviews and revenue audits that ensures casinos have adequate internal controls in place to accurately report revenue and pay gaming taxes and utilizes Division resources efficiently. According to the Division, in

July 2011 the Audit Section established goals for reviewing high-risk areas and conducting revenue audits in Fiscal Year 2012. The Audit Section should communicate its goals to Audit Section staff and incorporate the goals into the Audit Section's annual workplans. If the Division is able to complete a revenue audit or the four highest-risk accounting compliance reviews annually at each casino, it will gain further assurance that casinos are accurately reporting their adjusted gross proceeds and paying gaming taxes. We found that seven of the 11 revenue audits that the Audit Section completed in Fiscal Year 2010 had findings related to casinos' recording of adjusted gross proceeds. These types of problems can result in casinos paying the incorrect amount of gaming taxes to the State. In fact, one of the 11 revenue audits completed in Fiscal Year 2010 resulted in a gaming tax adjustment. Therefore, there is a risk that casinos that did not receive a revenue audit could have similar problems that have not been identified and corrected.

Further, if the Division determines that it cannot complete all applicable compliance reviews at each casino, a risk-based method is important in ensuring that the areas with the most problems are corrected. Our analysis of the Fiscal Year 2010 compliance reviews demonstrates that it is likely that more problems would have been corrected if the Audit Section had completed more accounting compliance reviews, because the rate of problems found in the accounting compliance reviews was higher than the other compliance review areas. A risk-based approach is also the most effective use of limited staff resources, because it allows staff to focus on the areas in which the most problems are likely to be found.

Recommendation No. 3:

The Division of Gaming (the Division) should ensure that casinos are accurately reporting their adjusted gross proceeds, are paying gaming taxes, and have the required minimum internal controls in place by:

- a. Ensuring goals for completing revenue audits and compliance reviews are communicated to all staff.
- b. Implementing a process for ensuring the Audit Section accomplishes its goals, utilizes its resources efficiently, and completes either a revenue audit or the four highest-risk accounting compliance reviews at all casinos each year.
- c. Implementing a risk-based process for completing compliance reviews based on established goals.

Division of Gaming Response:

- a. Agree. Implementation date: July 2011.

In July 2011, the Division's Audit Section established an audit plan for Fiscal Year 2012 that included a schedule and established goals for performing either a revenue audit or the four highest-risk accounting compliance reviews at each casino. This plan has been clearly communicated to the Audit Section staff by management. The audit plan will be reviewed on a quarterly basis by each Audit Manager with the Chief Auditor, beginning in October 2011, to ensure the section stays on track to achieve its goals. The audit plan may be modified during these quarterly reviews to address resource issues and to achieve the highest level of coverage possible with available resources.

- b. Agree. Implementation date: October 2011.

In July 2011, the Division's Audit Section established an audit plan for Fiscal Year 2012 that included a schedule and established goals for performing either a revenue audit or the four highest-risk accounting compliance reviews at each casino. This plan has been clearly communicated to the Audit Section staff by management. The audit plan will be reviewed on a quarterly basis by each Audit Manager with the Chief Auditor, beginning in October 2011, to ensure the section stays on track to achieve its goals. The audit plan may be modified during these quarterly reviews to address resource issues and to achieve the highest level of coverage possible with available resources. Although these goals are similar to past goals, staff turnover, prolonged vacancies, and training needs had a significant, negative impact on the section's ability to meet past goals. Adequate staffing levels and fully trained staff will facilitate achievement of the section's current audit plan and goals.

- c. Agree. Implementation date: July 2012.

The Division's Audit Section currently uses a risk-based model for revenue audit selection. The Audit Section is currently in the process of developing a similar model for completing compliance reviews. This model will be aligned with Division goals for the completion of compliance reviews and revenue audits performed by the Audit Section. The selection of compliance reviews to be performed will be reviewed and updated throughout the year based on the Audit Section's risk assessments.

Enforcement of the Gambling Payment Intercept Act

In accordance with statute (Section 26-13-114, C.R.S.), the Department of Human Services maintains a database of Colorado residents who are delinquent in paying child support and the amount they owe. On July 1, 2008, the Payment Intercept Act (Section 24-35-601, et seq., C.R.S.) began requiring casinos to search the database of persons owing child support payments in Colorado prior to issuing a W-2G tax form (W-2G) to casino patrons. A W-2G is an Internal Revenue Service tax form that is issued to casino patrons who win slot machine jackpots of \$1,200 or more, certain poker jackpots of \$600 or more, or poker tournament prizes above \$5,000. The casinos must attempt to search the database before paying such jackpots or prizes to the winner. If the winner is listed in the child support database, the casino is required to withhold from the prize or jackpot the amount of child support owed and transfer it to the Department of Human Services so the funds can be applied toward the individual's outstanding child support balance. If the amount intercepted by the casino is less than the cash prize, the remainder is paid to the winner. According to our analysis, in Calendar Year 2010 casinos completed searches on about 111,000 W-2G recipients, which resulted in about \$312,000 intercepted from 194 individuals who were delinquent in paying child support.

The Payment Intercept Act grants the Department of Revenue, which oversees the Division of Gaming, with rulemaking authority for implementing the Payment Intercept Act. The Payment Intercept Act also requires the Department to create and maintain the automated system that casinos use to search the child support database, or contract with another entity to do so. The Department has contracted with a private entity to serve as the system operator for the Gambling Payment Intercept system. For each W-2G issued, casinos must either search the Gambling Payment Intercept system or document the reason that a search could not be performed, such as a system outage. The Department has established a rule (1 C.C.R., 210-1-05) requiring casinos to maintain a log of W-2Gs issued when the casinos cannot access the Gambling Payment Intercept system due to no fault of their own. We refer to these logs as "outage logs."

The Division of Gaming, as the licensing authority for casinos, has statutory authority to sanction casinos that do not comply with the Payment Intercept Act. As a result, the Division has developed a process to annually monitor casino compliance with the requirements set forth in the Payment Intercept Act. Specifically, at the end of each calendar year the Division determines the number of W-2Gs issued to prize winners by each casino, including the W-2Gs issued during a system outage, to calculate the number of searches a casino should have performed. The Division then compares the aggregate number of W-2Gs issued

by each casino against the aggregate number of searches of the child support database the casino performed, obtained from data reports from the Gambling Payment Intercept system that casinos use to query the child support database. Using the aggregate W-2G and search data, the Division calculates the percentage of prize winners each casino searched in the child support database to generate a compliance rate for each casino. In general, the percentage of searches completed by a casino is the compliance rate. In Calendar Year 2010, the Division-calculated compliance rates for casinos ranged from 88 percent to 103 percent. As discussed later, under the Division's calculation method, compliance rates can exceed 100 percent because casinos may search an individual more than once or casino employees may use incorrect system logins. The Division has the authority to issue disciplinary or administrative actions based on casino noncompliance with the Payment Intercept Act.

What audit work was performed and what was the purpose?

We evaluated the Division's procedures for monitoring casino compliance with the Payment Intercept Act by evaluating the Division's benchmark for the acceptable level of noncompliance and method for calculating the compliance rates of casinos. Specifically, we selected a nonstatistical sample of three of the seven casinos that had voluntarily submitted electronic W-2G records to the Department of Revenue; the Department does not have electronic W-2G records for the other 34 casinos because those casinos either submitted hard copy W-2G records or did not submit W-2G records. Casinos are not required to provide these records to the Department. We reviewed the W-2G records for Calendar Year 2010 for the three casinos and compared them to data on searches of the Gambling Payment Intercept system, which we obtained from the system operator, to identify the W-2Gs that the casinos had successfully searched and those that had not been searched. From this comparison, we calculated a compliance rate for each of the three sampled casinos. We compared the results of our analysis to the results of the Payment Intercept Act reviews conducted by the Division for the three sampled casinos for Calendar Year 2010 to determine the reliability and accuracy of the Division's method for assessing casino compliance. Finally, we interviewed Division staff and reviewed Division guidance provided to casinos through rules, required minimum internal controls, and casino compliance review letters to determine whether the Division provided sufficient guidance on how to implement the Payment Intercept Act.

How were the results of the audit work measured?

- **Statutory Compliance Benchmark.** As discussed previously, statute (Section 24-35-605, C.R.S.) requires casinos to attempt to search the child support database every time they issue a winning patron a W-2G.

However, due to system outages, the casinos are not always able to successfully search the child support database. In instances in which the casino is unable to receive information from the child support database after attempting to search the Gambling Payment Intercept system, the Payment Intercept Act [Section 24-35-605(2)(a), C.R.S.] permits casinos to pay the patron his or her winnings. Although statute allows a casino to pay winners when the casino is unable to obtain information from the Gambling Payment Intercept system, statute does not allow casinos to pay winners for simply failing to attempt a search.

- **Method for Assessing Casino Compliance.** According to statute [Section 24-35-606(1), C.R.S.], “a licensee that fails to comply with the provisions of [the Payment Intercept Act] shall be subject to sanctions by [the Division].” Therefore, the Division is responsible for developing adequate procedures for monitoring casino compliance with the Payment Intercept Act and sanctioning casinos for noncompliance.

What problem did the audit work identify?

Overall, we found that the Division’s method for assessing casino compliance with the Payment Intercept Act is unreliable and does not provide casinos timely feedback on identified noncompliance issues. These problems are discussed below.

- **Inaccurate Determination of Casino Compliance.** Overall, we found that the Division had overestimated the rate of casino compliance for each of the three sampled casinos. For example, for one casino the Division calculated a compliance rate of 102 percent, while our analysis showed a compliance rate of 98 percent. This difference means the Division believed the casinos were in compliance with the Payment Intercept Act slightly more often than the casinos actually were. We also found that two of the sampled casinos had not searched 18 winning patrons in the Gambling Payment Intercept system in Calendar Year 2010. We searched the Gambling Payment Intercept system for these 18 patrons and found that none were in the database, meaning that none of these individuals owed child support. For Calendar Year 2010, the Division calculated an overall compliance rate for all casinos of about 99 percent; however, based on the results of our match for the three sampled casinos and the deficiencies we identified in the Division’s method for determining compliance, this figure appears to be overstated. The overestimate may be a result of the Division’s method of comparing aggregate data and combining compliance rates for casinos that share employees, which we discuss later.

- **Untimely Review.** We found that the Division's current review to determine casino compliance with the Payment Intercept Act is time-consuming and does not provide timely feedback to casinos. Division staff collect electronic W-2G data and Gambling Payment Intercept system search data for all casinos for the entire previous year, which are large data sets for Division staff to analyze. Additionally, Division staff conduct the review and provide feedback to the casinos about their compliance after the end of each calendar year, so problems may not be addressed until well after the noncompliance has occurred.

Why did the problem occur?

- **Unreliable Method for Assessing Casino Compliance.** We found that the aggregation method used by the Division to determine casino compliance is not precise and does not render accurate results. As discussed previously, the Division determines compliance by comparing the aggregated number of W-2Gs issued by a casino to the aggregated number of searches performed by that casino. This aggregated matching method does not provide the Division an accurate compliance rate, nor does it allow the Division to determine the precise reasons why casinos do not conduct searches of the Gambling Payment Intercept system. For example, the Division's method can result in inflated casino compliance rates because the method does not account for instances when casinos perform multiple searches for the same patron, either by mistake or because the patron has a hyphenated name. For example, if a casino conducts two Gambling Payment Intercept system searches of one patron and chooses not to search the database for a second patron, the Division would still count the two searches as having been conducted for different patrons and calculate the casino's compliance rate at 100 percent. Likewise, if the Division reviewed a casino that issued 15 W-2Gs and conducted 15 system searches, under the Division's current method it would conclude that the casino performed all of the required Payment Intercept Act searches; however, the casino could have performed 15 searches on the same patron and the Division would not identify the casino's noncompliance.

In addition, the Division's method does not accurately account for casino employees who use the incorrect casino login when searching the Gambling Payment Intercept system. According to the Division, an employee who works at two casinos has two different logins to conduct searches and can accidentally use the wrong login when performing searches. An incorrect login results in one casino's compliance rate being overstated by one search and another casino's compliance rate being understated by one search. The Division currently accounts for casino

employees who use incorrect logins by aggregating all W-2Gs and system searches for the casinos that share employees and calculating a combined compliance rate for these casinos. However, this method does not allow the Division to determine a compliance rate for each casino individually. During the Division's Calendar Year 2010 review, 13 casinos had a compliance rate greater than 100 percent, which appears to be partly the result of casinos conducting multiple searches for a single patron or casino employees using incorrect logins.

Lastly, the Division's compliance calculation does not account for instances in which the Gambling Payment Intercept system is inaccessible due to a system outage. As a result, the Division can calculate compliance rates for some casinos lower than they actually are. For example, a casino that issued 100 W-2Gs to 100 winners should search the Gambling Payment Intercept system 100 times, unless there was a system outage at the time the casino performed a search. If the casino did not search five winners because of system outages, which is allowable under statute, the casino's compliance rate is still 100 percent. Under the Division's compliance review method, the Division would calculate an incorrect compliance rate of 95 percent for the casino.

The most reliable and precise method for determining casino compliance with the Payment Intercept Act is performing a detailed electronic match of all W-2Gs issued to winners with the names of the individuals who were searched by casinos for a set period of time. Currently, only some casinos have electronic W-2G data. The Division should implement this type of detailed electronic match of casinos with electronic data on a risk basis, through random sampling, or both if it has the resources available. The Division should also explore ways to obtain electronic data from casinos that do not currently provide it. Audit Command Language (ACL) software is one tool that can be used to perform the electronic match quickly and efficiently. The Division should utilize ACL or comparable software to perform the detailed electronic matches of W-2G and search data. The Division should also incorporate its Payment Intercept Act review into its standard compliance reviews. If the Division has limited staff resources, it should perform the reviews on a periodic basis, looking at shorter periods of time and smaller amounts of data. Incorporating the Payment Intercept Act review into ongoing compliance reviews would allow the Division to use its resources more efficiently by reducing the amount of data necessary for staff to review; provide the casinos with more regular, timely feedback on compliance with the Payment Intercept Act; and still provide the Division a more reliable method for determining casino compliance than is currently in place.

- **Untimely Review.** The Division's current review schedule does not provide timely feedback to casinos because the Division reviews compliance with the Payment Intercept Act at the end of each year, not periodically throughout the year as it does with other compliance reviews. The Division's review method is also time-consuming for staff who perform the review because the staff assess compliance for each casino using a full year of W-2G and search data. According to the Division, it began conducting its review of casino compliance with the Payment Intercept Act for Calendar Year 2009 when the Gaming Commission expressed interest in the amount of funds that casinos had intercepted through searches of the Gambling Payment Intercept system. However, the Division did not initially consider itself responsible for reviewing casino compliance of the Payment Intercept Act because it did not believe it was an area of Division responsibility. As a result, the Division has not yet developed a timely or efficient process for assessing casino compliance with the Payment Intercept Act.
- **Insufficient Guidance.** The Division has not provided adequate guidance to casinos on how they should implement the Payment Intercept Act. Instead, the Division has provided guidance on an ad hoc basis as part of its annual review, such as directing casinos to establish internal review procedures to verify that all W-2Gs were searched. We also found that the rules promulgated by the Department (1 C.C.R., 210) are broad and do not provide casinos specific guidance for implementing the internal controls needed to comply with the Gambling Payment Intercept Act. Although the Division is responsible for ensuring casinos comply with the Payment Intercept Act, it has not formalized its expectations for how casinos should implement the Payment Intercept Act's requirements through required minimum internal controls, such as requiring casinos to have procedures in place to ensure casino employees use the correct login. Additionally, the Division has not developed policies and procedures for issuing administrative actions when casinos do not comply with the Payment Intercept Act. Although the operator of the Gambling Payment Intercept system has provided casinos training on the Payment Intercept Act, casinos reported that written guidance and clear minimum internal controls outlining the requirements of the Payment Intercept Act would be useful.

Why does this problem matter?

Because the Division does not have an accurate and precise method for determining casinos' compliance with the Payment Intercept Act, it cannot reliably identify the casinos that do not adequately perform the statutorily required child support database searches, determine the precise reasons why

casinos do not perform adequate searches, or take appropriate enforcement action to ensure compliance. As noted above, we searched the Gambling Payment Intercept system for the 18 patrons we identified through our review of searches at two casinos. Although we did not find that any of these patrons were in the Gambling Payment Intercept system, there is a risk that casinos are not identifying winning patrons who owe outstanding child support and that their child support debts will not be collected, as required by statute.

Finally, additional debts beyond unpaid child support have been recently added to the Payment Intercept Act. Effective July 1, 2011, unpaid criminal restitution debt is part of the Gambling Payment Intercept system. In addition, during the 2011 Legislative Session, the General Assembly passed and the Governor signed Senate Bill 11-051, adding any unpaid debt due to the State to the Payment Intercept Act. Therefore, if the Division does not implement procedures to ensure casinos fully comply with the new requirements in the Payment Intercept Act, the State and individuals may not receive money owed to them.

Recommendation No. 4:

The Division of Gaming (the Division) should improve its regulation of casino compliance with the Gambling Payment Intercept Act (Payment Intercept Act) by:

- a. Implementing a method for accurately calculating casino compliance and identifying the reasons for casino noncompliance. This should include performing detailed electronic matches between casino W-2G tax form (W-2G) data and the Gambling Payment Intercept system search data for a set period of time based on risk, a random sample, or both to gain more precision.
- b. Incorporating the detailed electronic matches into the Division's standard ongoing compliance reviews to provide more timely feedback to casinos.
- c. Developing internal control guidance for casinos to follow on implementing the Payment Intercept Act.

Division of Gaming Response:

Partially agree. Implementation date: July 2012.

- a. The Division is committed to exploring ways to improve our current compliance procedures related to the Payment Intercept Act. After evaluation of the current processes and identification of potential

improvements, the Division will update the procedures as warranted. The availability of electronic W-2G data for performing such matches is limited. Further, detailed reviews of compliance will be time-consuming and resource intensive. The Division believes that while our current process for determining compliance does not provide for absolute assurance, it does provide for reasonable assurance and is the most efficient use of our limited resources. However, the Division will evaluate the feasibility of requiring casinos to compile electronic W-2G data to provide to the Division. If this is deemed feasible, it could allow the Division to perform compliance reviews using random sampling for a set period of time. When this legislation was passed, the Division did not receive any additional resources for implementation or enforcement of this program.

- b. The Division is in the process of implementing more frequent compliance reviews in this area that will provide more timely feedback to casinos on their compliance with the Payment Intercept Act. However, as stated in part a above, the availability of electronic W-2G data is limited. Further, performing detailed electronic matches is time-consuming and resource intensive. The Division is committed to continuing to explore new ways to improve the timely feedback to casinos on their compliance with the Payment Intercept Act based on information and resources available to do so. Improvements identified in regard to the timely feedback to the casinos will be communicated to staff and included in the compliance process.
 - c. The Division believes that 1 C.C.R., 210-1, adopted by the Colorado Department of Revenue, provides clear guidance for casinos to follow in implementing the requirements of the Payment Intercept Act. Further, the Division believes that developing internal controls would be duplicative of Department rules and an inefficient use of Division resources. However, if the Division determines that casinos should be required to compile and produce electronic W-2G data, as referred to in the Division's response to Recommendation No. 4, part a, it will develop internal controls to address that requirement. Colorado Interactive, the developer and operator of this system, has provided training to the casino industry on numerous occasions for use of the system. Colorado Interactive will continue to provide training as new phases of the intercept program are implemented.
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Progressive Enforcement with Administrative Actions

The Division and Gaming Commission have developed a system of corrective actions to enforce the Gaming Act, gaming regulations, and required minimum internal controls. The Division’s corrective actions are progressive, meaning that the severity of action increases with repetitive and ongoing violations. The Division has two levels of corrective actions, administrative and disciplinary. Administrative actions are imposed for less serious violations of gaming laws and regulations, including violations identified during compliance reviews. Disciplinary actions are imposed for more serious instances of licensee noncompliance, such as having revoked software on slot machines, and carry the possibility of license suspension or revocation. This section focuses specifically on the Division’s process for issuing administrative actions resulting from compliance reviews, because those reviews and actions are the primary method used by the Division to identify and address casino noncompliance with gaming rules and regulations. The types of administrative actions imposed by the Division are explained in the table below in order of severity.

Division of Gaming Administrative Actions		
Administrative Action	Explanations of Actions	Level of Division Approval Required
Verbal Warning	Verbal notice given to the licensee for minor violations	Staff issue without approval
Warning Letter	Written notice of violations given to the licensee and requires the licensee’s response	Manager
Assurance of Voluntary Compliance	Licensee must sign a written pledge that it will not commit future violations	Division Director
Source: Office of the State Auditor’s summary of the Limited Gaming Act of 1991, Division of Gaming policies, and staff interviews.		

What audit work was performed and what was the purpose?

Audit work focused on Division compliance reviews and resulting administrative actions because they are the primary means used by the Division to assess and enforce casino compliance with gaming rules, regulations, and minimum internal controls. We reviewed the Division’s compliance review and administrative action data and selected a judgmental sample of 14 casinos for which the Division

had identified issues of noncompliance during a total of 26 compliance reviews conducted between July 2007 and December 2010. We selected 13 of the casinos to provide adequate coverage of both Division field offices in Cripple Creek and Central City, and selected one casino that the Division had reported as having a history of noncompliance and administrative actions. We sought to determine whether the Division had progressively issued administrative actions against the sampled casinos for repeated noncompliance violations identified by Division compliance reviews. Additionally, we reviewed the compliance reviews on file for each of the sampled casinos for which the Division identified casino noncompliance, but had not issued an administrative action to determine whether an administrative action would have been appropriate. Because disciplinary actions typically do not arise from compliance reviews, our audit work did not review disciplinary actions issued by the Division.

How were the results of the audit work measured?

According to the Gaming Act (Section 12-47.1-202, C.R.S.), the function of the Division is to license, implement, regulate, and supervise the conduct of gaming in Colorado. According to Division staff and management, the Division's enforcement process typically begins with a verbal warning, followed by a warning letter, and then an assurance of voluntary compliance, if the same violation is identified at a subsequent compliance review. However, because there are no written rules or policies on the Division's progressive enforcement process, we looked broadly at the Division's responsibility for overseeing licensees to ensure compliance with statute and regulations, with enforcement actions being a fundamental component of the Division's oversight duties.

What problem did the audit work identify?

We found that the Division has not consistently issued administrative actions in a progressive manner. Specifically, for the 14 sampled casinos, we identified eight (31 percent) out of the 26 compliance reviews from July 2007 through December 2010 in which either the Division had not issued an administrative action when it identified a violation, or the administrative action issued was not progressive. Specifically, we found:

- **Lack of Any Administrative Action.** In four (15 percent) out of the 26 compliance reviews, the Division identified four casinos with noncompliance in multiple areas of required minimum internal controls and recurring violations but did not issue an administrative action. For example, in one compliance review, Division staff documented violations in all five areas of a casino's surveillance system but did not issue the casino an administrative action. According to the Division's progressive

system, staff should have issued an administrative action for these multiple violations.

- **Lack of Progressive Administrative Action.** In four (15 percent) out of the 26 compliance reviews, the Division documented repeated and ongoing violations of the required minimum internal controls at four casinos, yet the Division issued repeated verbal warnings, the lowest level of administrative action. For example, in one compliance review, Division staff documented a violation involving storage of supplies related to table games, a violation that had been noted during two previous compliance reviews and for which two verbal warnings had been issued. Based on the Division's progressive system, staff should have issued an escalated administrative action such as a warning letter.

Why did the problem occur?

We found that the Division does not always issue administrative actions progressively, or in some cases at all, because it has not provided adequate guidance to staff on the circumstances under which an administrative action should be issued, nor has it established written policies or procedures to guide staff on the application of progressive administrative actions. The Division's existing enforcement policies are limited to procedures concerning how staff should draft and issue administrative actions to casinos and which managers should review the administrative actions. With the lack of written policies, procedures, and guidance, the Division relies on staff discretion to determine whether an administrative action is warranted, resulting in inconsistencies. Although the Division has a supervisory review process in place to examine the results of the compliance review, the process is not designed to determine whether the administrative actions are issued progressively or consistently.

With the Division identifying some kind of violation in about 340 compliance reviews among the 41 casinos in Fiscal Year 2010, a system of enforcement that is progressive and applied consistently should improve casino compliance with the State's gaming laws, regulations, and required minimum internal controls.

Why does this problem matter?

By not consistently issuing administrative actions in a progressive manner or issuing actions at all, the Division has allowed some casinos to repeat violations and not fully implement required minimum controls. For example, two casinos were issued three consecutive verbal warnings for the same violations of the required minimum internal controls when the Division should have issued the casinos at least a warning letter. Specifically, both casinos had repeated violations related to the inventory of items, such as decks of cards and dice, kept in the

gaming area, which can increase the risk of unfair or fraudulent play. Additionally, when the Division does not issue administrative actions consistently when it identifies violations of the gaming rules and required minimum internal controls, inconsistent enforcement could result in casinos' not adequately addressing noncompliance issues identified and the Division's treating casinos inequitably.

Recommendation No. 5:

The Division of Gaming (the Division) should develop a progressive, consistent, and equitable system for addressing violations identified in compliance reviews and ensuring casino compliance with gaming laws, regulations, and required minimum internal controls by:

- a. Implementing written policies and procedures for issuing administrative actions, including providing clear guidance on when the Division will issue an action and when the action will be progressive.
- b. Conducting training for Division staff on administrative action policies and procedures that provides clear guidance on when an administrative action is warranted and the type of action required to encourage casino compliance.
- c. Expanding the supervisory review to include administrative actions to ensure the actions are progressive, consistent, and equitable, in accordance with the policies and procedures implemented in part a, and including the supervisory review process in written policies and procedures.

Division of Gaming Response:

Agree. Implementation date: July 2012.

- a. The Division is committed to ensuring that administrative actions are consistent, equitable, and reasonable. The overriding purpose of administrative action is to gain compliance with applicable internal controls and gaming regulations and laws. The progressive nature of administrative actions plays an important role in achieving compliance. However, consideration of the unique circumstances and mitigating factors involved in every case is an important component to ensuring that regulation is reasonably administered. While the Division recognizes that general procedures for issuing administrative actions would be beneficial, such procedures must allow for discretion on the part of the Division. The Division will review our existing

procedures and make necessary modifications to underscore the importance of progressive, consistent, and equitable administrative actions while addressing the need for discretion. Supervisory review of verbal warnings will be addressed in our revision of these procedures.

- b. In conjunction with our implementation of part a above, the Division will conduct training of affected staff to reinforce the importance of progressive, consistent, and equitable administrative actions and to address any changes in procedures resulting from this process.
 - c. In conjunction with the implementation of parts a and b above, the Division will incorporate the appropriate procedures to ensure adequate supervisory review of all administrative actions. Currently, all administrative actions, with the exception of verbal warnings, require supervisory review. Supervisory review of verbal warnings will be addressed in our revision of these procedures.
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