



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA

Gambling Regulation and Oversight

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Major Findings:

- We found strengths and significant weaknesses in Minnesota's regulation and oversight of gambling.

- The Gambling Control Board does not adequately detect and deter noncompliant activities by organizations involved in charitable gambling. Some organizations have excessive expenses and make small contributions to charities (pp. 21-39).



- The Minnesota Racing Commission provides thorough and multi-layered oversight of horse

racing but does not adequately oversee the card club at Canterbury Park (pp. 50-56).

Some types of gambling need stronger state oversight.

- The Lottery protects the integrity of its scratch and online games with a comprehensive set of security procedures (pp. 66-74).
- The Alcohol and Gambling Enforcement Division does not effectively use its authority to inspect Indian casinos. However, regulation by tribes and the federal government mitigate limitations in state oversight authority and inspection practices (pp. 80-89).

- Some agencies involved in gambling regulation do not have sufficient staff expertise and do not use technology effectively (p. 104).
- Improvements in Minnesota's regulation of gambling are possible without a reorganization of the agencies involved. Specifically, we do not think consolidating the agencies would be useful (p. 105).

Key Recommendations:

- The Gambling Control Board should more effectively use its authority and resources to detect and deter noncompliance, and the Legislature should reconsider the scope and focus of the Gambling Control Board's responsibilities in regulating charitable gambling (pp. 41-45).
- The Racing Commission should expand card club oversight and increase staff expertise in this area (p. 61).
- The Alcohol and Gambling Enforcement Division should fully utilize its casino inspection authority and change how it assigns staff to casino oversight (pp. 98, 100).
- All of Minnesota's gambling regulatory agencies, except the Lottery, should make better use of technology to fulfill their oversight and regulatory responsibilities (pp. 43, 62, 98).

The Gambling Control Board has reduced its charitable gambling compliance presence.

Report Summary

Gambling is a multi-billion dollar industry in Minnesota, regulated by four state agencies. The Gambling Control Board regulates pull-tabs, bingo, and other forms of charitable gambling; the Racing Commission regulates horseracing and a card club at Canterbury Park; the Minnesota State Lottery regulates—and promotes—lottery games; and the Alcohol and Gambling Enforcement Division (AGED) in the Department of Public Safety oversees certain aspects of Indian casino gaming.

We evaluated each agency's regulatory activities, including how each one ensures the integrity of games and the proper distribution of proceeds. We also assessed whether Minnesota's segmented approach to gambling oversight is an effective and efficient organizational structure.

The Gambling Control Board Does Not Adequately Detect and Deter Charitable Gambling Noncompliance

As a complex, cash-based industry, charitable gambling is vulnerable to abuse, including cheating, theft, and misuse of proceeds. Over 1,400 licensed nonprofit organizations run charitable gambling operations at approximately 3,000 sites, using over 20,000 employees and an unknown number of volunteers. The board uses standard techniques, such as licensing, education, and compliance reviews to enforce laws regulating game play and the use of proceeds.

The Legislature should consider new approaches to regulating the use of charitable gambling proceeds.

We found shortcomings in each area, and taken together, the board's regulatory efforts do not adequately detect and deter noncompliant activities by organizations involved in charitable gambling. For example, the board does not verify that all licensing requirements regarding criminal history are met, and the board has not been able to provide the amount of training it believes is necessary. In addition, the Gambling Control Board does not conduct enough compliance reviews and site inspections. The board reviews each licensed organization's operations on a

rotating basis, and its goal is to review each organization every two years. In calendar year 2003, board staff were on pace to conduct compliance reviews of each organization every 2.7 years. The board has also cut back on the number of on-site inspections it does. According to the board, recent budget and staff cuts have reduced its compliance presence statewide.

To more effectively adjust to budget cuts, the board needs to change how it uses some of its resources. Specifically, the board needs to invest in technology, systematically analyze data to better understand compliance problems and trends, and target site visits and compliance reviews on organizations that show signs of problems. We also think the Legislature should critically reassess the scope and focus of the board's regulatory responsibilities. For example, the Legislature may want to shift regulatory responsibility for permitting small gambling events from the state to local governments or eliminate it altogether. The Legislature may also want to change how the state regulates the use of charitable gambling proceeds by focusing more on the proportion of proceeds going to charity and less on the proportion used for gambling business expenses.

Some Organizations Involved in Charitable Gambling Have Excessive Expenses

State law limits how much charitable gambling organizations can spend on total gambling business expenses, such as rent and salaries. For most types of charitable gambling, organizations can spend up to 55 percent of gross profit (gross receipts less prizes) on business expenses. However, compliance with the law is measured in such a way that organizations can spend more on business expenses on an annual basis than the limit suggests is appropriate. Fiscal year 2003 tax data showed that, measured on an annual basis, 592 organizations (43 percent) exceeded the business expense limits established in statute. We estimated that the 127 organizations that exceeded the spending limit by over 25 percent spent, on average, four to five times the amount to raise a dollar for lawful purposes than organizations that spent within the limit.

In overseeing the card club, the Racing Commission relies too heavily on self-regulation by Canterbury Park.

The amount of money consumed by gambling business expenses is important because it affects the amount of money available for charities.

The Racing Commission's Oversight of the Canterbury Park Card Club Is Inadequate

While the Racing Commission provides effective oversight of horse racing, the commission relies too heavily on Canterbury Park for oversight of card club activities. The Racing Commission employs stewards, veterinarians, and barn technicians to oversee racing. Each of these personnel has a specific role in ensuring the integrity of horse racing. In contrast, the Racing Commission does not have personnel with sufficient expertise to oversee card club activities, and the commission relies too much on self-regulation by Canterbury Park.

Racing Commission staff rely on Canterbury Park employees to notify them of problems that arise in the card club, but the commission may not be aware of all relevant surveillance observations. During fiscal year 2004, Canterbury Park personnel observed 28 incidents, such as cheating and theft, that should have been reported to the Racing Commission, but commission staff remember being informed of only 23 of them. In addition, the commission does not regularly verify compliance with the card club plan of operations or review and approve expenditures from a special card club fund over which the commission has specific authority.

The Lottery Adequately Ensures the Integrity of Its Games

The Lottery is both the promoter and regulator of the games it offers, a situation that could compromise game integrity. However, the Lottery does an adequate job protecting the security of both its scratch and online games and ensuring that Lottery proceeds are allocated properly. While no system is foolproof, the Lottery has comprehensive procedures that minimize the risk of cheating. It verifies the physical security of scratch game tickets, protects against ticket tampering, and ensures secure

electronic ticket validation. Finally, the Lottery investigates any suspicious activity regarding game play to make certain that only fairly purchased and valid tickets are redeemed. As the Lottery's use of technology has improved, the number of these investigations has decreased.

The Lottery also adequately ensures that its proceeds are allocated appropriately. In general, the Lottery holds retailers responsible for selling and properly redeeming tickets. Because the Lottery is a state agency, distribution of its proceeds to different state funds is done through the state's accounting system. The Lottery works with the departments of Finance, Revenue, Natural Resources, and Human Services to ensure that revenues are properly allocated.

The Alcohol and Gambling Enforcement Division Does Not Effectively Use Its Authority to Inspect Casinos

Minnesota's 11 Indian tribes operate 18 casinos located around the state. Tribes have primary responsibility for ensuring that these casinos operate with integrity, and the state has secondary oversight authority. Legal agreements between the state and each tribe, called "compacts," establish rules for blackjack and slot machine gambling and grant casino inspection rights to the Minnesota Department of Public Safety's Alcohol and Gambling Enforcement Division (AGED) for the purposes of verifying compact compliance.

The division's casino inspections are the primary means through which the state can directly assess compliance with slot machine and blackjack compacts, but AGED does not make full use of its inspection authority. Specifically, the division has focused its oversight on physical inspections of selected slot machines in a casino. Under the compacts, AGED has access to an array of information, including relevant casino information systems, casino financial and internal control audits, compliance data from tribal regulatory authorities, and AGED's own observations. With a few

The Lottery has comprehensive procedures that reduce the risks to its games.

The Alcohol and Gambling Enforcement Division should make better use of available information when inspecting Indian casinos.

We did not find a compelling case to consolidate the state's gambling regulatory agencies.

exceptions, AGED has not fully used these sources, so its judgments regarding compact compliance are based on limited information. In addition, AGED's policy of assigning sworn law enforcement officers to tribal gaming matters on a part-time basis has hindered casino oversight.

Segmenting Gambling Regulation Among State Agencies Is Reasonable

Minnesota's gambling laws and regulatory approach have evolved as the scale and nature of legal gambling have changed, resulting in a segmented and specialized oversight structure. We identified a number of common problems among three of the four regulatory agencies we evaluated (the Lottery being the exception). The problems include inadequate use of technology and strategic analysis and gaps in staff expertise. However, we did not find a compelling case for consolidating the agencies. Many of the deficiencies we identified did not appear to result from the state's segmented approach to gambling

oversight, nor would solutions necessarily result from consolidation.

Still, strengthening Minnesota's regulation of gambling will require a cooperative, multi-agency response. For example, to effectively target its criminal investigation resources, AGED needs to work with the other agencies to define compliance priorities and use these priorities to guide which cases should be referred to the division and when. In addition, there may be opportunities for the Gambling Control Board and Racing Commission to share technology support and for the board to improve its information exchange with the Department of Revenue.

The full evaluation report, *Gambling Regulation and Oversight* (#pe05-02), includes the agencies' responses and is available at 651/296-4708 or:

www.auditor.leg.state.mn.us/ped/2005/pe0502.htm

Summary of Agency Responses:

The Commissioner of Public Safety and directors of the Gambling Control Board, Minnesota Racing Commission, and Minnesota State Lottery responded to the report in separate letters. All four respondents wrote that their agencies have already acted on many of the report recommendations and will pursue others as resources allow.

In addition, Gambling Control Board Executive Director Tom Barrett wrote that the report "supports the Gambling Control Board's efforts for maintaining the integrity and security of the games, but also recognizes the limited oversight of the licensed charitable organizations." Racing Commission Executive Director Richard Krueger wrote, "there is nothing here that surprises us. All of the recommendations have at one time or another been discussed by staff... as needs of this Commission." Lottery Executive Director Clint Harris wrote, "The report recognizes ... the extensive and comprehensive measures undertaken by the Lottery to ensure the security and integrity of lottery games." He added that the Lottery has implemented three of the recommendations, but disagrees with the fourth recommendation to conduct national, rather than state-only, criminal history checks on retailers because doing so "is not cost-effective and would have no appreciable effect on the security of lottery games." Commissioner of Public Safety Michael Campion wrote that the report "does identify some areas of concern and we appreciate the recommendations...made."