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FISCAL IMPACT REPORT

SPONSOR: Campos DATE TYPED: 02/28/03 HB _____

SHORT TITLE: Oversight of Racetrack Gaming Machines SB 595

ANALYST: Gonzales

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY03	FY04	FY03	FY04		
			Significant See Narrative	Recurring	General Fund

(Parenthesis () Indicate Expenditure Decreases)

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	FY04			
	Potential Increase		Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Gaming Control Board (GCB)
State Racing Commission

SUMMARY

Synopsis of Bill

Senate Bill 595 amends sections of the Gaming Control Act to basically eliminate the requirement that gaming machines operated at racetrack casinos be connected to the central monitoring system located at the Gaming Control Board. More specifically, this bill would:

- Require **only** nonprofit gaming operator licensees to be connected to a central monitoring system.

- Require the Gaming Control Board to develop and operate an electronic data retrieval system that is capable of retrieving information gathered by a central computer monitoring and accounting system located on each racetrack gaming operator licensee's premises on a read-only, intermittent basis (not real-time). This is similar to the tribes.
- Require each racetrack gaming operator licensee to:
 1. install at its own expense a central computer system that is capable of continuously monitoring and auditing the operation, financial transactions and program information of each gaming machine on the programs pursuant to certain restrictions;
 2. designate an individual to be available at all times gaming machines are in operation, who shall have the authority to disable a gaming machine at the verbal instruction of the Executive Director of the Gaming Control Board; and
 3. not place back into play a gaming machine that has been disabled at the instruction of the Director until the machine has been reset.

Significant Issues

The Gaming Control Act requires the Gaming Control Board to operate a central monitoring system to regulate the operation of gaming machines by licensed racetracks and nonprofit gaming operators. The central monitoring system is a computer system designed to monitor the status and performance of gaming machines and collect data on a real-time basis. According to GCB, the system guarantees the fairness of the games to protect patrons; enables quick patron/venue dispute resolution; ensures that only approved games and machines are offered to the public; calculates the exact amount owed to the state in gaming tax; provides immediate verification of gaming-related data; and provides real-time regulation rather than requiring labor-intensive, after-the-fact audits.

As testimony before various Legislative, Racing Commission and Gaming Control Board meetings, racetrack casino operators have argued the current central monitoring system with the Gaming Control Board does not allow them to purchase and install the latest and most desirable gaming machines. By allowing racetrack casino operators to purchase and install an "off-line" monitoring system, they have to flexibility to install and operate more competitive slot machines desirable by their customers and patrons at their locations.

The Gaming Control Board states this bill may have a significant impact on the Board's ability to regulate gaming efficiently and cost-effectively and will have a significant impact on the Board's general fund budget. (The GCB is funded entirely from the general fund.) Among other things, the bill will (1) create two separate regulatory systems operating simultaneously at a substantially higher cost than the current central monitoring system; (2) reduce regulatory control; (3) eliminate the state's ability to obtain accurate financial information first-hand and ascertain gaming taxes owed immediately after they are earned; (4) require a special appropriation for an RFP to build the new system and a recurring supplemental appropriation to the Board's budget for a professional services contract to maintain the new system; (5) require significant changes to the Board's current rules, minimum internal controls, and operations; (6) require development of a plan for operation during a transition period; (7) eliminate the Board's ability to settle patron disputes immediately and monitor illegal breaches and critical errors; (8) eliminate the Board's ability to turn on and disable the machines in accordance with approved operating hours; (9) eliminate automated accounting and invoicing; (10) require the State to station agents on the ca-

sino floor during all operating hours; (11) require the addition of a minimum of 11 staff members with specialized training; (12) require that all racetracks operate the same slot accounting system; (13) eliminate the Board's ability to guarantee the legality of game software; and (14) potentially erode public trust in the honesty and integrity of gaming.

In a presentation to the Legislative Revenue Stabilization and Tax Policy interim committee on September 11, 2002, the Gaming Control Board provided the following benefits of the central monitoring system:

- Provides a strong regulatory framework for a largely cash business
- Guarantees the fairness of the game to protect the patron
- Enables quick patron/venue dispute resolution
- Ensures that only approved games and machines are offered to the public
- Calculated the exact amount owed the state in gaming tax
- Provides a daily report to each gaming operator licensee detailing game play and a full accounting of activity
- Allows the state first accounting of tax due and cost effective regulation
- Provides immediate verification of gaming related data
- Provides "real-time" regulation rather than after the fact, human based auditing
- Allows the state to disable machines if needed

The GCB would have less control over the racetracks although they bring in significantly more money to the general fund than nonprofits. For FY02, racetrack operators generated \$28.9 million in gaming tax that goes directly to the general fund while nonprofit operators generated \$592.7.

PERFORMANCE IMPLICATIONS

The Gaming Control Board raises a number of additional issues of performance implications as noted below:

General Information—States that regulate slot machines without a central monitoring system typically operate under a labor-intensive system that requires after-the-fact audits in which the state reconciles every transaction using a manual process. States without central monitoring systems typically are older gaming venues regulating multiple full-scale casinos for which switching to a central monitoring system would not be economically feasible. In contrast, the central monitoring system-based regulatory model provides immediate access to information, ensures the legality of software contained in the gaming machine, and makes it feasible for the State to regulate without a significant number of employees. The central monitoring system is specifically designed for markets like New Mexico to regulate electronic gaming devices through information access. The Board is currently operating a central monitoring system.

Requirement to Operate Two Systems—SB595 will require the State to run two systems simultaneously—the central monitoring system to which nonprofits operators' gaming machines will be connected, and a racetrack data retrieval system. Of the two systems, the central monitoring system is the more accurate, cost effective system. The bill, however, would remove racetrack gaming machines from the central monitoring system even though racetracks generate 98% of the State's gaming tax revenue. Of the 2,215 gaming machines currently connected to the central

monitoring system, only the 398 machines operated by nonprofit gaming operators would remain. In addition, the Board does not have the expertise to develop or maintain the new monitoring system and will be required to issue an RFP and contract for those services. See “Fiscal Implications” below.

Slot Accounting System v. Central System—Although the bill refers to a “central computer system” at each of the tracks, the bill seems to describe a slot accounting system. A slot accounting system is not a substitute for a central monitoring system. A slot accounting system is a *management* tool to aid business management in the operation of a casino. A central monitoring system is a *regulatory* tool. The central monitoring system ensures accurate gaming tax billing, collects data on game play, monitors the performance and status of gaming machines, ensures the legality of the game software, and tests and configures gaming information, such as maximum bet, maximum prize and game selection.

Data Captured—It is not clear what operational and program information will be available from the slot accounting systems proposed in the bill. For example, we do not know whether the systems will capture events for security purposes or provide detailed information on each game, such as maximum bet, maximum award, and payback percentage, so the State can ensure the machines comply with standards set in the Gaming Control Act and Board rules.

Testing of Gaming Machines—The Gaming Control Act requires that each gaming machine be tested to ensure it meets approved game specifications, maximum payouts, payback percentages, and other technical requirements. It is not clear how the bill ensures the conformity of gaming machines placed at racetrack gaming operator venues or whether the State will have to obtain and run multiple slot accounting systems to perform testing and auditing on gaming machines before they are placed in the field. In addition, these systems will require upgrades, representing an additional expense to the State.

Accounting for State Gaming Tax Revenues; Master Resets and Reconciliations—A master reset clears out a gaming machine’s soft meters, which count cash wagered, and starts over. The State must have the meter readings to ensure reliable accounting of revenue data. A machine that has been master reset, but has had no reconciliation performed, could report substantially less net revenue electronically to the State than the money actually collected from the gaming machine. Under the current central monitoring system, the State has access to all soft meter data, ensuring accuracy of gaming revenues reports. The State re-enrolls the gaming machine after it has been master reset and captures the pertinent data for reconciliations, ensuring that money can be accurately tracked.

Regulatory Oversight on Casino Floor—The Board will be required to station agents at each casino during all hours in which the casino is open. The agents must be present any time casino winnings are counted to certify casino revenue and make sure the State gets its tax revenue. In addition, Board agents must be present whenever gaming machines are opened or disabled for any reason so that the agent may observe and verify each procedure, transaction, or software change. This will significantly increase the amount of time gaming machines must be taken out of play.

Additional Regulatory Personnel—Because the new system will require Board agents’ physical presence on casino premises, it will be necessary to recruit, hire and train 11 additional employees (one senior special agent, three special agents, six accountants with slot accounting system

audit training and one supervisor) to ensure adequate coverage during casino operating hours. These additional personnel also are required because the Board currently does not have the expertise to audit slot accounting systems; that expertise is not necessary with the central monitoring system. See “Fiscal Implications” below.

Patron Disputes—Board agents also will be required to be on casino premises whenever there are patron disputes. The current central monitoring system minimizes downtime of gaming machines in the event of patron disputes. The central monitoring system can verify gaming machine activity and patron winnings, often resolving patron disputes within minutes. Loss of the system will mean the machine becomes evidence in a patron dispute and cannot be played until the dispute is resolved.

Turning on and Disabling Machines—Implementation of a new system in which slot machines are not tied to the Board’s central monitoring system will eliminate the Board’s ability to bring up and disable the machines in accordance with approved operating hours or in the event of error or fraud. Any operation outside of authorized hours could be deemed an expansion of gaming and eliminate the tribes’ obligations to make revenue-sharing payments under the compacts. The concept of having a racetrack employee manually enable and disable machines also is archaic and creates increased risk of human error.

Transition Period—The bill will require development of a plan for operation during a transition period from the central monitoring system to the slot accounting systems and data retrieval system. It will not be possible to disable all racetrack gaming machines from the central system and connect them to the racetracks’ slot accounting systems without significant downtime and testing periods. Revenues lost during the transition period cannot be determined at this time.

Standard Protocol—All racetracks will be required to obtain and operate the same slot accounting system to ensure standard protocol. This may mean rewiring and restructuring current game floors at an undetermined cost to the racetracks. If each track is permitted to have a different system, the Board would have to translate the various protocols and ensure the same data was being retrieved from all locations before being consolidated into financial reports. This would constitute additional expense for the State as well as increase the potential for inaccurate data.

Nonprofit Gaming Taxes and Maintenance Cost—Maintenance cost for the central monitoring system for FY2002 was \$443,402. Nonprofit gaming operators paid \$592,748 in gaming taxes in FY2002.

Failure to Address the Issue—The bill may not alleviate the perceived problem—that is, the ability of racetracks to purchase gaming devices of their choice and compete with tribal gaming facilities. Even without the central monitoring system, the New Mexico market is too small to attract other manufacturers to the state or to be an incentive for current manufacturers to make a wide variety of their machines available. This is particularly true now that we are in a replacement, rather than new, market. If the problem is the limited number of machines that can be sold in the New Mexico non-tribal gaming market rather than the cost of engineering to communicate with the current central monitoring system, the bill will not eliminate the problem and could hamper regulatory efforts.

FISCAL IMPLICATIONS

In 1998 the Legislature appropriated \$4 million nonrecurring funds for an automated central gaming machine monitoring system, as required by statute, that allows GCB to continuously monitor gambling activity on each licensed non-tribal gaming machine in New Mexico. The GCB awarded a contract in a competitive bid in December 1998 for a total cost of \$3.97 million. The initial startup cost was \$1.79 million and required 5 annual payments of \$440.0 thereafter. The current contract ends December 31, 2003. At the end of the contract period, ownership of the software and hardware would vest with the GCB. Additional cost may be incurred to meet hardware obsolescence or to address the rapidly changing technological advancement in the gaming world. Cost of support for infrastructure and maintenance of this system would need to be appropriated by the legislature.

According to the Gaming Control Board, this bill will have a major impact on its budget as indicated below:

Special appropriation:	
Analysis of need	\$ 15,000
New system implementation	\$750,000
DDS circuits	\$ 5,200
DDS hardware	\$ 4,000
Travel relating to new system	\$ 7,500
Training relating to new system	<u>\$ 14,000</u>
Total Special Appropriation	\$795,700

Supplemental appropriation (recurring):	
Professional services contract to maintain system	\$250,000
Personal Services (salaries and benefits)	
Seven slot accounting system auditors (incl. supervisor)	\$718,200
One senior special agent; three special agents	\$201,103
Overtime to cover casino operating hours	\$124,820
Travel expenses	\$ 65,000
Training	\$ 38,000
Field offices	\$ 6,400
Field supplies	\$ 52,400
Office supplies	\$ 30,000
Computer hardware/software	\$100,000
Additional vehicle(s)	<u>\$ 25,000</u>
Total Supplemental Appropriation	\$1,610,923

There is, however, a potential for increases revenue to the general fund by having a greater selection of more desirable slot machines at the racetracks. It is unclear whether the level of revenues that will be generated by the new machines, in excess on revenues that would be generated by the current machines, would offset the additional expenses that will be incurred by the GCB to implement and maintain the new system.

ADMINISTRATIVE IMPLICATIONS

The bill provides for an entirely different regulatory model than is currently in place. Therefore, the Board would be required to promulgate a significant number of new rules, and amend a significant number of existing rules, to regulate effectively under the new dual-system. The process

could take up to six months, taking into account drafting, notice, hearing, and publication times.

TECHNICAL ISSUES

On page 2, line 24, “Nonprofit agency operator” should be “nonprofit gaming operator”.

Some inconsistencies exist in the bill as noted below:

- References to the type of system to be installed by racetracks are inconsistent.
On page 2, lines 20-21, the bill refers to a “central computer monitoring and accounting system”
On page 3, lines 3, 9, and 18 the bill refers to a “central computer system”.
Neither of the terms is defined.
The correct term is “slot accounting system.”
- On page 3, lines 23-24, this section of the bill refers to disabling a gaming machine on the verbal instruction of the executive director
On page 6, line 10, this section requires only that each gaming machine be capable of “having play suspended”.
Disabling a gaming machine and suspending play are completely different actions. It is essential that a gaming machine be disabled upon direction of the executive director, and not merely that the game is capable of being suspended.
- On page 3, lines 8-14, this section of the bill requires Board access to gaming machine data through the racetrack’s computer system
On page 6, lines 5-7, this section of the bill states that racetracks’ gaming machines must be capable of being linked to the Board’s “central system” for the purpose of being monitored. This disparity makes it unclear how the State is to access data.

OTHER SIGNIFICANT ISSUES

The Board, working with the central monitoring system contractor, has proposed an enhancement to the current system which would expand the potential game offerings for racetrack and nonprofit gaming operator licensees without eliminating the central monitoring system. The Board has requested a special appropriation to finance this project. To date, preliminary appropriation bills do not include funding for this enhancement.

POSSIBLE QUESTIONS

With only nonprofit gaming operators being directly connected to the GCB’s central monitoring system, what would the difference be between the State’s investment in the central monitoring system for infrastructure and maintenance support compared to the revenue collected by the non-profits?

What are the benefits to the State to have only the nonprofits connected to the central monitoring system?