



**Report
to
The LEGISLATIVE FINANCE COMMITTEE**



New Mexico Racing Commission
Gaming Control Board
Operational Effectiveness of Gambling Oversight in New Mexico
May 15, 2013

Report #13-02

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May 15, 2013

Mr. Jeffrey S. Landers, Chairman
New Mexico Gaming Control Board
4900 Alameda Blvd. N.E.
Albuquerque, New Mexico 87113

Mr. Robert M. Doughty, Chairman
New Mexico Racing Commission
4900 Alameda Blvd. N.E.
Albuquerque, New Mexico 87113

Dear Chairmen Landers and Doughty:

On behalf of the Legislative Finance Committee (Committee), I am pleased to transmit the *Evaluation of Operational Effectiveness of Gambling Oversight in New Mexico* for the Gaming Control Board and the New Mexico Racing Commission. The evaluation team assessed the effectiveness of regulatory oversight of gaming and horse racing in New Mexico.

The report will be presented to the Committee on May 15, 2013. The report was reviewed with agency staff at the exit conference which was conducted on April 2, 2013. The Committee would like a plan from the agencies to address recommendations in this report within 30 days from the date of the hearing.

I believe this report addresses issues the committee asked us to review. We appreciate the cooperation and assistance from the agencies' staff.

Sincerely,

A handwritten signature in cursive script that reads "David Abbey".

David Abbey, Director

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Racetrack casinos generated \$33 million in wages in 2011.

The New Mexico horse industry produces \$503 million in goods and services.

Fourteen tribes operate a total of 26 casino facilities in New Mexico.

In 2012, the New York Times found the horse racing industry to be “mired in a culture of drugs and lax regulation.”

Horse racing and gaming play an important role in the economy and culture of New Mexico. The Consensus Revenue Group estimates that the state will receive \$143 million in revenue from gaming and racing activities in FY13. A 2011 American Gaming Association report stated New Mexico’s racetrack casinos employed over 1,500 people and generated over \$33 million in wages in 2011. According to an economic study conducted by the American Horse Council, the New Mexico horse industry produces \$503 million in goods and services and employees 35.7 thousand FTEs directly. In FY12, casino-style gaming at racetrack and tribal casinos, non-profit venues, and bingo facilities produced \$1.02 billion in gaming revenues that generated \$133.5 million in taxes and revenue share to the state. Pari-mutuel wagering generated \$113 million in total revenue before winnings were deducted for FY11, the most recent year reported.

The federal Indian Gaming Act (IGA) authorized tribes to conduct casino-style gaming, with a caveat that states must also authorize tribal gaming. The Gaming Control Act (GCA) was enacted in 1997 authorizing tribes to open casinos, as well as racetracks and non-profit organizations. The GCA also created the Gaming Control Board (GCB) to serve as the regulatory agency overseeing all gaming activities in the state of New Mexico. The GCB manages licensing of all racetrack and non-profit casino employees, gaming manufacturers and distributors. They also oversee the state’s tribal gaming compacts with 14 tribes through the State Gaming Representative.

The Horse Racing Act (HRA), enacted in 1933, allows horse racing and pari-mutuel wagering in New Mexico. The New Mexico Racing Commission (NMRC) oversees compliance with the HRA through licensing and enforcement activities. Five racetracks currently operate in New Mexico, and in 2013 a sixth racetrack license was released from litigation by a state appeals court, allowing the NMRC to move forward in awarding the license. A 2012 New York Times article highlighted concerns in New Mexico horse racing related to a high prevalence of horse breakdowns and equine doping.

In two June 2012 LFC briefs, staff highlighted various issues with gaming and horse racing in New Mexico including insufficient equine drug testing, tribal gaming compact revenue sharing and compact negotiations, gaming revenues subsidizing horse race purses, and declining or flat general fund appropriations for regulatory agencies. This evaluation looks to review both the GCB’s and NMRC’s ability to effectively enforce statute and monitor compliance, examine the state’s position in tribal gaming compacts as some of these contracts are set to expire, and examine the state of the horse racing industry in New Mexico since the introduction of gaming at racetracks and in light of concerns over integrity in the industry.

This evaluation found that provisions in the Gaming Control Act and tribal gaming compacts limit the Legislature’s ability to monitor the Gaming Control Board’s effectiveness as an oversight agency. The GCB also does

not focus the majority its audit efforts on racetrack casinos, which produce the largest revenues and are the driver of growth in investigations. In addition, draft tribal gaming compacts address revenue sharing with a never before used formula to address free play without a notable benefit to the state from these revenues.

The New Mexico Racing Commission faces significant challenges in regulating the horse racing industry in New Mexico. The NMRC does not adequately test for equine doping compared to other states; does not fully audit simulcast revenues, gaming revenues allocated for purses and tax payments made to the state by racetracks; and lacks sufficient resources to properly vet potential licensees and provide reporting to assist the NMRC in its mission.

KEY FINDINGS

Insufficient human resources and unclear tribal gaming compacts hamper oversight of one billion dollars in casino gaming revenues. The Gaming Control Board (GCB) is challenged in overseeing New Mexico's 26 tribal gaming facilities, five racetrack casinos, and 55 non-profit locations.

The GCB audit team is tasked with reviewing all gaming in the state with a limited staff and not based on risk. The GCB has 13 auditor positions, of which three are vacant as of March 2013. As a result, GCB staff audit non-profit gaming facilities more and tribal and racetrack casinos less. Additionally, lack of a dedicated tribal gaming audit staff at the GCB creates additional work for the GCB's audit team overseeing racetrack and non-profit gaming.

The state has struggled to appoint and retain a State Gaming Representative. This position has been held by seven governor-appointed individuals since 1999, an average of 15 months per representative. Not having a dedicated State Gaming Representative and staff could hamper effective oversight of the compacts as well as weaken communication with the tribes.

The GCB initiated investigations for an average of 11.4 percent of inspections performed between FY08 and FY12, with the majority of these investigations occurring at non-profit gaming operations and racetrack casinos. The most investigations occurred in FY08, the year with the most inspections in the five-year period of FY08-FY12. However, in FY 2010, total inspections dropped to 665, and 113 investigations were performed, representing a 17 percent ratio, the highest among the years sampled. Even as the total number of investigations dropped, the percentage of racetrack investigations conducted grew to 49 percent as of FY12.

Gaming compact provisions limit the GCB's ability to ensure tribal compliance, creating significant risk in overseeing the state's interests in tribal gaming. The Gaming Control Act of 1997 set the statutory foundation for tribal gaming in New Mexico. The state has since entered into gaming compacts with 14 tribes who operate 26 gaming facilities.

Tribes and racetracks account for \$987 million in gaming and generated \$129 million in revenue to the state in FY12.

The longest the State Gaming Representative position has remained vacant is 11 months, from May 2012 to the publication of this report in April 2013.

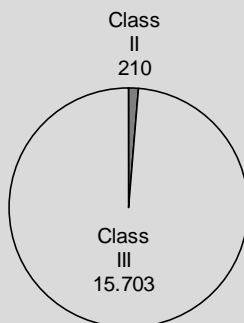
The main driver of growth in investigations is racetrack casinos.

The confidentiality clause in tribal gaming compacts limits information the Legislature can access to monitor tribal compliance.

The 2001 tribal gaming compacts expire June 30, 2015.

Overall tribal net win has grown only 4 percent from FY08 to FY12, with revenues shifted among an increasing number of casinos.

Tribal Gaming Machine Count FY12



Source:GCB

Tribes renegotiating the terms of gaming compacts is an opportunity to improve legislative oversight. The Legislature currently lacks access to tribal gaming data and is unable to independently verify the state gaming representative's level of oversight and the tribes' adherence to the compacts. Neither the 2001 or 2007 compacts clearly define which state entities can access data. The confidentiality clause in tribal gaming compacts limits information the Legislature can access to monitor tribal compliance.

Terms negotiated with the Navajo Nation for a new tribal gaming compact do not adequately address market oversaturation, free play, and availability of reporting. The governor entered into negotiations with the following tribes signed onto the 2001 tribal gaming compacts in 2012: the Pueblo of Acoma, the Jicarilla Apache Nation, the Mescalero Apache Nation, the Navajo Nation, and the Pueblo of Pojoaque. The current compacts these tribes are gaming under expire June 30, 2015.

Market erosion between tribal casinos and racetracks is a concern in renegotiating tribal gaming compacts. The new compact would authorize the Navajo Nation to open two more casinos in addition to the three casinos currently operating, for a total of five. There is no mention in the compact language of geographic distance between current or future gaming facilities authorized for the Navajo Nation and current gaming operations of other tribes or racetracks.

The Navajo Nation draft compact takes steps to limit the growth of Class II gaming in tribal casinos. Language within the draft compact limits number of Class II gaming machines the Navajo Nation can operate to 20 percent between all facilities. Florida put a similar requirement in its 2010 gaming compact with the Seminole Tribe.

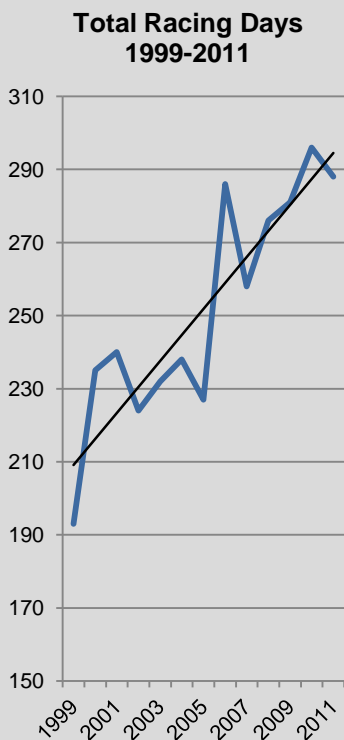
The GCB does not consistently track changes in Class II and III machine counts over time, making it impossible to enforce any limitations on Class II gaming growth. Currently, the GCB counts gaming machines at tribal casinos annually, distinguishing between Class II and Class III. However, the GCB does not track this data at the same point year over year, and has not retained data further back than June 2011.

Draft compact language for the Navajo Nation introduces a new solution to free play revenue recognition which does not provide material benefit to the state. The draft 2013 Navajo Nation compact applies a new formula for determining what free play value should be included in an "adjusted net win." This formula is not being used in any other state in addressing free play for revenue sharing payment calculation.

Horse racing has an important role in New Mexico's economy, but faces challenges in the current entertainment industry landscape. The horse racing industry has examined various ways to increase interest in the sport and build sustainability. Horse racing is tied to many other agricultural industries in the state, including breeding, training, and veterinary science, among many others.

As recently as November 2012, the GCB was in mediation with various tribes to resolve the disagreement on how free play should be addressed in calculating net win.

Horse racing purse sizes grew a total of 274 percent per race between 1999 and 2011, far outpacing national averages.



Source: NMRC

From 2007 to 2011, New Mexico averaged 3.5 fatalities per 1,000 starts.

The current mix of quarter horse and thoroughbred races does not reflect wagering interest at the state's racetracks. New Mexico has a long history in quarter horse racing, and is one of few states that offer races for this breed of horse. Currently, racetracks offer 60 percent thoroughbred races during racing meets as conditions allow. However, wagering behavior indicates a greater interest in thoroughbred racing, with almost 70 percent of total wagering attributed to this one horse breed.

Since being introduced in 1999, gaming revenues have become the greatest driver of increasing purse sizes for New Mexico horse races. From 1999 to 2011, gaming revenues from racetrack casinos contributed over 50 percent of purses awarded in New Mexico horse races. Even with increased purse amounts, horse race attendance has declined since 2006. While racing attendance has declined, net win at racetrack casinos is double the total wagered on New Mexico horse races.

Weak authority and limited staffing capability hinders effective oversight of horse racing in New Mexico. The New Mexico Racing Commission faces significant challenges in bringing legitimacy back to the New Mexico horse racing industry. Consistent with reporting by the New York Times in 2012, horse fatalities in New Mexico are nearly double the national average.

While the NMRC issues a relatively high number of citations per horse race, fine amounts are lower than many other states and may not serve as sufficient deterrent to cheating. In 2011, New Mexico levied more fines than any state with the exception of California, although California ran seven times as many races as New Mexico.

With the low fine amounts compared with purse sizes and the lack of lifetime bans, the state's penalty structure for violations is weak, although recent legislation makes significant improvements. New Mexico's current statutory penalties do not exceed \$10 thousand for a single violation of the Act, drug or otherwise, and no language addresses the possibility of a lifetime ban. When compared with an average purse size in 2011 of \$20 thousand, a maximum \$10 thousand fine is not as significant as fines levied in other states.

Other states perform more frequent equine drug testing than New Mexico. The Association of Racing International has identified various states that perform more equine drug testing than New Mexico. The average among the other 32 states the ARCI surveyed is between three and four tests per race. New Mexico currently tests only the winning horse and one other horse, which is the least amount of testing among surveyed horse racing jurisdictions.

The NMRC has not received sufficient appropriations to increase equine drug testing frequency at New Mexico racetracks. Based on a two-year average of equine testing cost per race for the NMRC, it would cost \$722 thousand to test the winner and one additional horse per race, and \$1.1 million to test the winner plus two additional horses per race. The 2013 Legislature created an equine testing fund of \$350 thousand for FY15 and \$700 thousand for FY16 forward.

With the signing of Senate Bill 444 in 2013, the NMRC now has the authority to levy fines up to a maximum of \$100 thousand or the total purse amount, whichever is greater.

The newly formed equine testing fund alone is insufficient to perform the level of drug testing the NMRC would like to achieve with five racetracks.

Races conducted without a license, regardless of location, are a violation of the Horse Racing Act.

States differ on whether arming horse racing investigators is beneficial.

Racetrack reporting providing revenue and tax information are not currently designed to easily audit tax payments for accuracy.

New Mexico lacks sufficient investigators to monitor statutory compliance at racetracks during live race meets when compared to other states. As of February 2013, the state had four investigator positions with only two filled. While statute requires investigators at tracks at least four days per week, given the current number of filled positions, one investigator is generally at each track two to three days per week.

The New Mexico Racing Commission (NMRC) struggles to address illegal horse racing occurring in New Mexico. A KRQE investigative report about illegal racing in New Mexico highlighted the NMRC's inability to regulate these tracks. Statute dictates races conducted without a license, regardless of location, are a violation of the Horse Racing Act, but enforcing the Act based on identifying who is operating the illegal race meet may be difficult.

NMRC enforcement officers are not certified, presenting concerns over training and safety while on duty at New Mexico racetracks. NMRC investigators are required by statute to not carry firearms, but must have basic law enforcement training. Previous LFC briefs, as well as national press coverage, have spoken to various levels of criminal activity occurring at legal and illegal New Mexico racetracks.

Inaccurate data and a lack of oversight activities impede the New Mexico Racing Commission from effectively enforcing the Horse Racing Act. Pari-mutuel wagering taxes paid to the state by racetracks are self-reported, and are not audited by the NMRC on a regular basis. The Taxation and Revenue Department (TRD) does not track these tax dollars, so the NMRC becomes the de facto enforcement entity to ensure racetracks are abiding by state law in payment of pari-mutuel taxes.

The NMRC only requires audits of revenues and taxes from racetracks during live racing meets, which leaves 25 percent of wagering revenues unaudited. Between 2007 and 2011, simulcast only race days accounted for 81 percent of total pari-mutuel wagering days. Simulcast in-state wagering revenues outside of live meets, which are taxable, are not audited by the state. Simulcast wagering revenues in 2011 alone accounted for 57 percent of total wagering revenues, of which only one third were audited.

Reported totals of gaming revenues reallocated to support horse racing purses vary greatly between the NMRC and the New Mexico Gaming Control Board (GCB). The GCB's totals for these revenues were reported at higher levels for the entire period racetrack casinos have been in operation, with one year the GCB reporting more than double the gaming purse distribution that the NMRC reported.

Review of provided financial statements for racetracks licensed to operate through the NMRC shows two racetracks are not adequately capitalized. The Downs at Albuquerque reported in their 2011 financial statements a deficit in shareholder's equity of \$3.9 million, and carry forward losses of \$10.4 million. Outstanding debt notes totaled \$5.5 million, of which \$3.1 million was owed to shareholders who lent funds to the Downs to be repaid

in 2013. Similarly, Ruidoso Downs' current liabilities of \$1.8 million include unsecured debt which can be called by the debt holders at anytime. This debt could be considered high risk, as Ruidoso Downs ended 2011 with only \$759 thousand cash on hand.

A lack of adequate IT resources and knowledge hinders the NMRC's ability to regulate horse racing activities. The NMRC regulates horse racing across the state of New Mexico offering licensing for 58 different race-related activities. Remoteness of track locations, the short turnaround time sometimes required in issuing licenses, and the ability to enforce disciplinary action taken at racetracks makes having adequate IT resources essential.

KEY RECOMMENDATIONS

The Legislature should:

Exercise its authority under the Compact Negotiation Act to request negotiations with compacted gaming tribes to amend compacts to increase legislative oversight of tribal gaming in New Mexico through:

Creating stipulations for formal cyclical legislative review of tribal gaming and compact compliance by both the state and tribes and clarifying compact language to define which state entities can review tribal data (the GCB, the State Auditor, the Taxation and Revenue Department and the Legislative Finance Committee) subject to maintaining current confidentiality standards in the compacts;

Update language regarding confidentiality in the Gaming Control Act to allow the Legislature and the State Auditor access to reports and data to assess the GCB's oversight function with the requirement that confidential data not be made public;

Statutorily create an independent Office of the State Gaming Representative to avoid extended periods of vacancy in this position;

Require future updates to equine doping penalties not be tied solely to recommendations from the Association of Racing Commissioners International (ARCI), but to any prevalent industry-accepted oversight organization to allow flexibility in adopting best practices;

Formalize the NMRC's role in addressing illegal racing in New Mexico;

Clarify the NMRC's role in remediating racetracks with high horse breakdown rates by granting the NMRC power to determine when a track requires intervention; establishing a remediation plan to be supervised by the NMRC or their contracted representative; and requiring reporting on progress and at completion of any remediation projects; and

Authorize the NMRC to put contingencies on license renewals of tracks with high financial risk or poor safety records.

Section 60-1A-11 NMSA 1978 states that a license applicant must be sufficiently capitalized pursuant to standards set by the commission to conduct the business covered by the license.

The GCB should:

Track and report to the Legislature counts of Class II and Class III gaming machines at a set time annually at minimum, and retain this data to track changes in machine counts over time; and

Segment work in the audit and enforcement divisions by risk factors and provide a minimum audit scope (audit annually or less frequently, on-site audit versus desk audit, etc.)

The NMRC should:

Enter into a Joint Powers Agreement with relevant state agencies such as the Department of Public Safety and the Gaming Control Board to enforce current statute and criminal code in addressing illegal racetracks in New Mexico;

Complete a budget plan for increased equine drug testing including frequency of race and out-of-competition testing, anticipated costs and funding sources (such as increases to licensing fees) to be included in the agency's FY15 budget request;

Report back to the Legislature with a proposal to bolster enforcement of the Horse Racing Act to be included in the agency's FY15 budget request; and

Cross-audit data on gaming revenues designated for purses with the Gaming Control Board to validate proper transfer of these revenues.

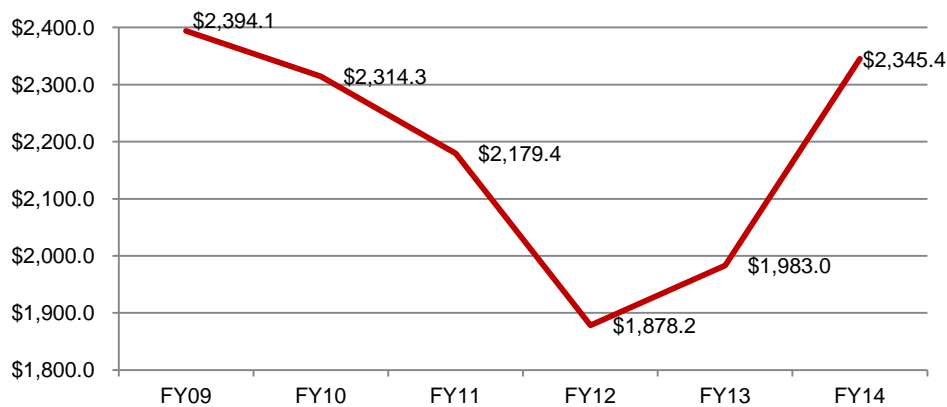
BACKGROUND INFORMATION

Horse racing and gaming play an important role in the economy and culture of New Mexico. The Consensus Revenue Group estimates that the state will receive \$143 million in revenue from gaming and racing activities in FY13. A 2011 American Gaming Association report stated New Mexico's racetrack casinos employed over 1,500 people and generated over \$33 million in wages in 2011. According to an economic study conducted by the American Horse Council, the New Mexico horse industry produces \$503 million in goods and services and employees 35.7 thousand FTEs directly. In FY12, casino-style gaming at racetrack and tribal casinos, non-profit venues, and bingo facilities produced \$1.02 billion in gaming revenues that generated \$133.5 million in taxes and revenue share to the state. Pari-mutuel wagering generated \$113 million in total revenue before winnings were deducted for FY11, the most recent year reported. The New Mexico Racing Commission (NMRC) oversees horse racing in the state, while the Gaming Control Board (GCB) provides oversight for racetrack casinos and manages tribal gaming compacts.

In two 2012 LFC briefs, staff highlighted various issues with gaming and horse racing in New Mexico including insufficient equine drug testing, tribal gaming compact revenue sharing and compact negotiations, gaming revenues subsidizing horse race purses and declining or flat general fund appropriations for regulatory agencies.

The New Mexico Racing Commission (NMRC). The NMRC was created pursuant to Sections 60-1A-1 through 60-1A-30 NMSA 1978. The NMRC's mission is to provide regulation in an equitable manner to New Mexico's pari-mutuel horseracing industry to protect the interest of wagering patrons and the state of New Mexico in a manner which promotes a climate of economic prosperity for horsemen, horse owners and racetrack management. Five commissioners comprise the NMRC, appointed by the Governor and approved by the Senate. The NMRC enforces and administers statute by creating rules and regulations pertaining to horse racing. The NMRC achieves this with 20 authorized FTE through licensing of all racing participants, oversight and judgment of races and racetrack operations, drug testing of select horses, investigations and enforcement of rules and regulations, testing of pari-mutuel payouts, and oversight of racetracks.

**Chart 1. NMRC Appropriations
FY09- FY14
(In thousands)**

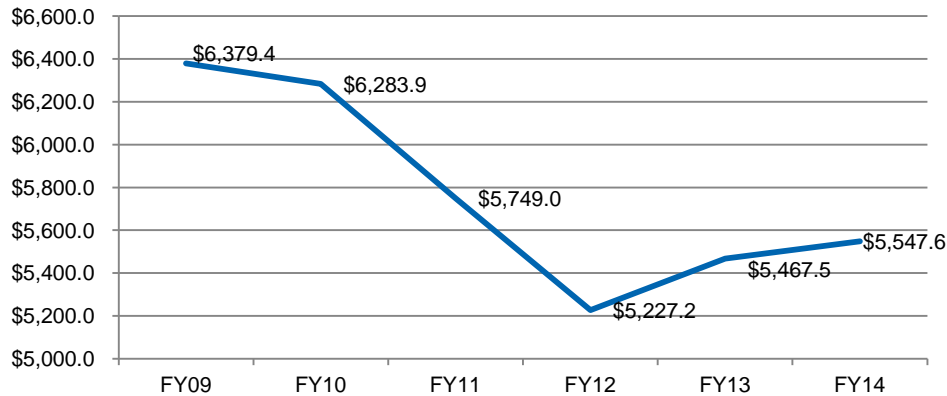


Source: GAA

Five racetracks operate in Farmington, Albuquerque, Hobbs, Ruidoso, and Sunland Park, with a state appeals court releasing the sixth and final racetrack license in March 2013. All five racetracks operate casinos licensed through the GCB. In addition to the five race meets conducted by these tracks, the Downs at Albuquerque operates a race meet during the New Mexico State Fair. The Horse Racing Act stipulates that a race meet must last a minimum of 17 days, and the NMRC approves the dates and duration of each race meet.

The Gaming Control Board (GCB). The GCB was created through the passage of the Gaming Control Act in 1997, Sections 60-2E-1 through 60-2E-62 NMSA 1978. The GCB regulates non-tribal casino gaming at racetracks and non-profit venues, bingo operations, and oversees tribal gaming compacts with 14 New Mexico tribes. The GCB consists of five members, four appointed by the Governor and confirmed by the Senate, with the final member ex-officio as the chairman of the New Mexico Racing Commission. Three board members are full-time, salaried employees of the state.

**Chart 2. GCB Appropriations
FY09- FY14
(In thousands)**



Source: GAA

Tribal Gaming. The U.S. Congress enacted the Indian Gaming Regulatory Act (25 U.S.C. Sections 2701 through 2721) in 1988 to regulate the conduct of gaming on Indian tribal lands. The Act also established the National Indian Gaming Commission (NIGC) as the federal government’s oversight entity. The Act identifies three classes of Indian gaming:

Class I: Social games solely for prizes of minimal value or traditional forms of Indian gaming engaged in by individuals as a part of, or in connection with, tribal ceremonies or celebrations. Class I gaming is fully under the jurisdiction of tribes.

Class II: Bingo and similar games which are played for prizes, including monetary prizes, which are either explicitly authorized by the state or are not explicitly prohibited by the state. Class II gaming does not include games such as blackjack or electronic games such as slot machines. Class II gaming is also fully under tribal jurisdiction, as long as the tribe passes an ordinance authorizing this type of gaming.

Class III: All forms of gaming that do not fall within the definitions of Class I or Class II. Class III gaming typically includes casino-style games. Class III gaming requires the tribe to pass an ordinance and operate in a state permitting this type of gaming. The tribe and the state must enter into a compact and gaming must be conducted conforming to this compact. Tribes must submit compacts to the Department of the Interior for approval and publication in the Federal Register.

State Oversight of Tribal Gaming. New Mexico currently has compacts with 14 tribes to operate Class III gaming. While each tribe signs an individual compact with the State, the tribes are commonly broken into two groups based on what provisions were included in the compacts and when they were signed. These are the 2001 compacted tribes and the 2007 compacted tribes.

Table 1. New Mexico Class III Gaming Compacted Tribes

2001 Compacted Tribes	2007 Compacted Tribes
Pueblo of Acoma, Jicarilla Apache Nation, Mescalero Apache Nation, Navajo Nation, and Pueblo of Pojoaque	Pueblos of Isleta, Laguna, Ohkay Owingeh, Sandia, San Felipe, Santa Ana, Santa Clara, Taos, and Tesuque
Compacts expire June 30, 2015	Compacts expire June 30, 2037

Source: Tribal Gaming Compacts

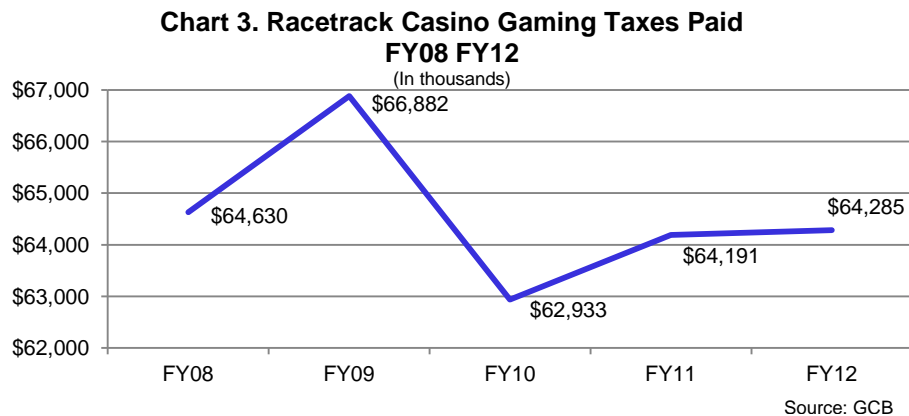
The GCB monitors tribal and state compliance with the compacts through the statutorily-designated State Gaming Representative.

Revenue Sharing. The tribal gaming compacts include a provision for tribes to share a percentage of Class III gaming revenues with the state in exchange for exclusive rights to conduct this type of gaming with the exception of racetrack and non-profit veterans and fraternal organizations as stipulated in the Gaming Control Act. In calculating the amount tribes will share with the state, the following definitions are relevant:

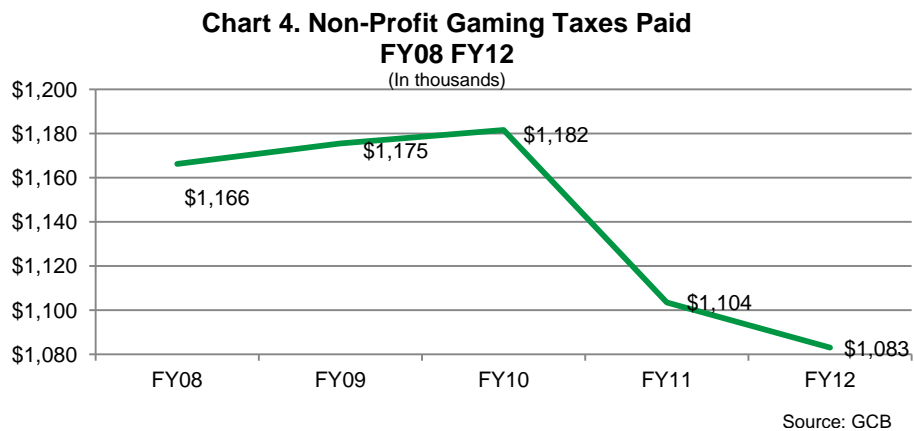
Net Win: Total amount wagered in Class III gaming at a gaming facility on all gaming machines less the amount paid in prizes to winning patrons. The 2007 compact includes language to say prizes awarded as part of a players’ club program could not be deducted from net win. From this total, tribes may deduct specific expenses as defined in the compact. Net win is used to calculate the percentage of revenue share tribes render to the state.

Free Play: A term commonly used to define promotions where players can wager on Class III gaming devices some value provided by the casino and not a player’s cash or cash equivalent. In essence, the player is able to play for free.

Racetrack Casinos. The Gaming Control Act and tribal gaming compacts stipulate that racetracks can operate casino-style slot machine gaming. The Act also requires racetrack casinos allocate 20 percent of gaming revenues to support horse racing purses. The GCB monitors these casinos electronically through a central monitoring system, allowing the GCB to accurately acquire revenue data to generate tax statements, control hours of gaming, and shut down dysfunctional machines or machines that have been tampered with. The GCB received \$2.5 million in the 2013 General Appropriations Act to modernize or replace the current central monitoring system.



Non-Profit Gaming. The Gaming Control Act also allows gaming at non-profit organizations such as veterans and fraternal organizations for active and auxiliary members. As of FY12, 55 non-profit venues operated gaming in New Mexico.



FINDINGS AND RECOMMENDATIONS

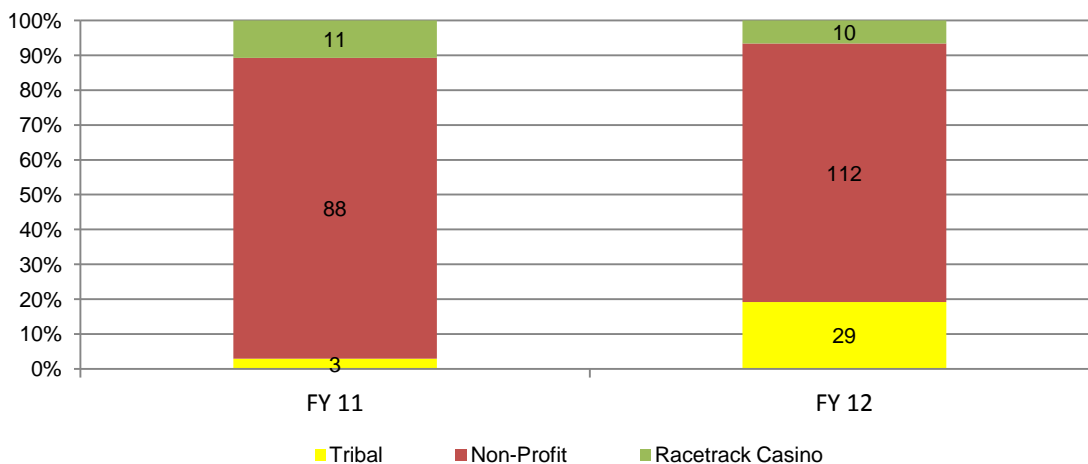
INSUFFICIENT HUMAN RESOURCES AND UNCLEAR TRIBAL GAMING COMPACTS HAMPER OVERSIGHT OF ONE BILLION DOLLARS IN CASINO GAMING REVENUES.

The Gaming Control Board (GCB) is challenged in overseeing New Mexico's 26 tribal gaming facilities, five racetrack casinos, and 55 non-profit locations due to limited staffing and inconsistent requirements in awarding racetrack casino licenses. In addition to monitoring compliance with tribal gaming compacts, the GCB also oversees non-tribal gaming in the state, made up of racetrack casinos and non-profit entities that conduct gaming to support charitable endeavors, as well as bingo operations. In FY12, non-tribal gaming net win totaled \$258 million. While this represents only a third of net win generated through tribal gaming, racetrack casino revenues help support horse racing in New Mexico, and both racetrack casinos and non-profit gaming operators contributed \$65 million in gaming tax revenue to the state in FY12.

The GCB audit team is tasked with reviewing all gaming in the state with a limited staff and not based on risk. The GCB has 13 auditor positions, of which three are vacant as of March 2013. The team is responsible for auditing a total of 86 gaming locations conducting tribal, racetrack, and non-profit gaming. Prior to FY11, a dedicated group of two auditors reporting directly to the State Gaming Representative conducted tribal audits, but due to attrition the GCB consolidated this task into the non-profit and racetrack audit group, adding one additional FTE. The GCB does not track time required to audit the different gaming entities, making it difficult to plan required travel accordingly to perform on-site audits at the 86 gaming facilities the GCB oversees.

GCB agency regulations stipulate the audit team perform periodic regular and special audits of licensed gaming venues but do not specify the frequency of reviews or whether they are based on risk factors, such as size of gaming revenues or history of non-compliance. As a result, GCB staff audit non-profit gaming facilities more and tribal and racetrack casinos less, even though tribes and racetracks account for \$987 million in gaming and generated \$129 million in revenue to the state in FY12. The GCB states in its 2012 annual report that it completes two audits annually for all racetrack and non-profit gaming facilities, which would total 120 regular audits for the state's five racetrack casinos and 55 non-profit gaming locations. In FY12, the GCB reports it completed 122 audits. While the total audits performed in FY12 indicate the GCB met its self-imposed audit goal, it appears the GCB has an opportunity to increase the number of ad hoc audits it performs from a total of two.

**Chart 5. GCB Audits Performed
FY11-FY12**



Source : GCB

Additionally, lack of a dedicated tribal gaming audit staff at the GCB creates additional work for the GCB’s audit team overseeing racetrack and non-profit gaming. Reviewing tribe-provided documentation demonstrated the GCB’s challenge in performing timely compliance reviews. In the case of one particular tribe, the GCB had reviewed the tribe twice in four years. The audit team’s ability to perform timely audits may be made more difficult with the potential opening of more tribal gaming facilities and a sixth racetrack casino.

The state has struggled to appoint and retain a State Gaming Representative. This position, responsible for the actions of the state within the gaming compacts and the single point of contact between the state and gaming tribes, has been held by seven governor-appointed individuals since 1999, an average of 15 months per representative. The longest the position remained vacant is 10 months, from May 2012 to the completion of this report in March 2013. Currently, a GCB board member is serving in this capacity while awaiting a permanent appointee. Not having a dedicated State Gaming Representative and staff could hamper effective oversight of the compacts as well as weaken communication with the tribes.

However, the Legislature has the authority to create a separate entity for the State Gaming Representative. If the Legislature creates an independent office of the State Gaming Representative, the entity could be modeled after other agencies like the office of the State Engineer, where the governor appoints a nominee and the Senate then confirms the position. This would increase legislative involvement in the oversight of tribal gaming in New Mexico and ensure this vital role does not go vacant for extended periods of time.

The GCB initiated investigations for an average of 11.4 percent of inspections performed between FY08 and FY12, with the majority of these investigations occurring at non-profit gaming operations and racetrack casinos. The most investigations occurred in FY08, the year with the most inspections in the five-year period of FY08-FY12. However, in FY 2010, total inspections dropped to 665, and 113 investigations were performed, representing a 17 percent ratio, the highest among the years sampled.

**Table 2. GCB Investigations
FY08-FY12**

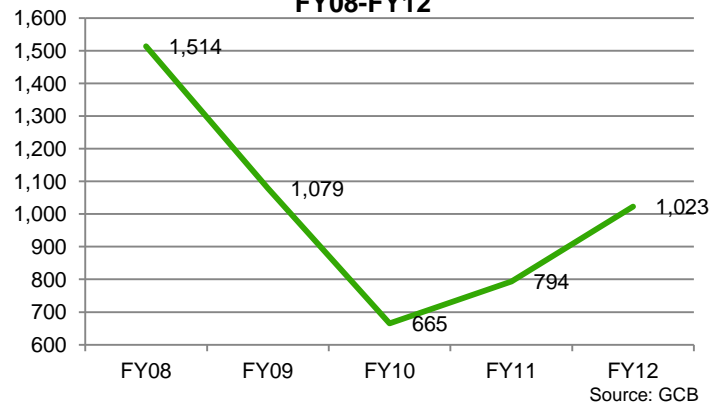
FY	Non-Profits	Racetrack Casinos	Gaming Vendors	Criminal Cases	Total Investigations by Year	% of Investigations Compared to Inspections Performed
2008	74	34	16	26	150	9.9%
2009	48	48	5	19	120	11.1%
2010	39	62	3	9	113	17.0%
2011	44	44	2	5	95	12.0%
2012	29	34	1	6	70	6.8%
Total	234	222	27	65	548	

Source: GCB

The main driver of growth in investigations is racetrack casinos. Even as the total number of investigations dropped, the percentage of racetrack investigations conducted grew to 49 percent as of FY12. While New Mexico has only five racetrack casinos, they produced \$247 million in net win and gaming tax revenues of \$64 million in FY12, compared with \$11 million in net win and \$1.1 million in gaming taxes produced by the 55 non-profit gaming operators in the state.

The GCB struggles to recruit enforcement staff to oversee gaming in New Mexico, risking potential statutory violations at the state’s gaming locations. The GCB enforces the Gaming Control Act and the Bingo Act and assists in monitoring compliance of tribal gaming compacts. GCB enforcement employees are certified peace officers, and the GCB struggles to recruit qualified officers to oversee gaming. As of March 2013, the GCB had five investigators, with two authorized vacant positions. With a supervisor’s assistance, these investigators inspect the state’s five racetrack casinos, 55 non-profit gaming operations, and 104 bingo operations, averaging 27.3 locations per investigator. As noted in chart 6, total inspections have dropped since FY08, hitting a low of 665 in FY10. In contrast, Arizona has ten investigators to oversee 21 tribal gaming casinos, the only legal casino gaming in the state.

Chart 6. Total Enforcement Inspections Performed FY08-FY12



Gaming license applications and GCB staff recommendations are confidential by statute, creating a transparency issue around the awarding of racetrack licenses. The GCB publicizes only the final decision on license applications, as addressed in GCB public meetings. However, in the case of racetrack operators, racing license applications made with the NMRC are not confidential. It is inconsistent to keep similar data for the same group of racetrack operators confidential in one licensing process and public in another. Given that racetracks must first possess a racing license to be eligible for a gaming license, transparency standards would improve both the racing and gaming application processes.

Gaming compact provisions limit the GCB’s ability to ensure tribal compliance, creating significant risk in overseeing the state’s interests in tribal gaming. The Gaming Control Act of 1997 set the statutory foundation for tribal gaming in New Mexico. The state has since entered into gaming compacts with 14 tribes who operate 26 gaming facilities. The Gaming Control Board, through the State Gaming Representative, is the state’s agent in administering the tribal gaming compacts.

Tribes renegotiating the terms of gaming compacts is an opportunity to improve legislative oversight. Statute dictates tribal gaming compact negotiations occur between the governor and the tribe. After agreeing to terms, the legislature ratifies the compacts. The Legislature, however, currently lacks access to tribal gaming data and is unable to independently verify the State Gaming Representative’s level of oversight and the tribes’ adherence to the compacts.

While the 2001 compacts stipulate data released to any official, agency, or entity of the state is confidential, they do restrict releasing information to a state entity for review. The 2007 compacts further define what information may be released and clarify that state entities may publicly release aggregate information derived from totaling comparable figures from annual financial statements of all New Mexico gaming tribes. However, neither the 2001 or 2007 compacts clearly define which state entities can access data. For this evaluation, all gaming tribes were approached to provide access to data that the GCB collected as part of their oversight role. Numerous tribes declined consent for LFC staff to review data related to compliance audits. The confidentiality clause in tribal gaming compacts limits information the Legislature can access to monitor tribal compliance.

Wisconsin gaming compacts require the tribes disclose annual financial audits to the Legislative Audit Bureau, which performs the function of the State Auditor, and in turn the bureau uses this data in their review of the agency overseeing gaming. This allows independent oversight of tribal gaming on behalf of the Legislature through sharing of non-public data, while protecting this data by requiring all public reporting be in aggregate.

Tribes participating in the 2001 compacts are currently negotiating with the governor’s office, as the current compacts expire June 30, 2015. Additionally, tribes gaming under the 2007 compacts have the option to sign onto the terms of newer compacts. It is timely for the Legislature to address concerns over transparency, accountability, and compliance before they are presented in final form for legislative approval.

LFC staff cannot determine if the GCB is accurate in its challenges to net win calculations with various gaming tribes, nor can LFC staff determine if the GCB is meeting its requirement under the compacts to enforce compliance on revenue sharing. The GCB has access under the tribal gaming compacts to review financial data, including financial statements, audits, and reports from tribal gaming agencies. GCB has used this detailed gaming data to challenge net win calculations of various tribes. However, citing confidentiality requirements in the Gaming Control Act, the GCB did not provide LFC staff data to independently verify the state's free play revenues. Auditing of revenue share calculations requires data on the gross gaming revenues the tribe retains after winnings are paid, deductions taken from the gross revenue figure to determine net win, and the revenue share payment then paid to the state (**Appendix B.**) Of these three items, only the total net win is public information, reducing transparency over key elements of revenue sharing calculations.

The main point of contention between the GCB and gaming tribes is how tribes calculate net win, defined as the casino's revenue intake after deducting winnings and allowable expenses. The 2001 compacts do not specifically address how free play should be treated for calculating net win, only referencing a deduction of undefined non-cash prizes. The 2007 compacts define patron winnings and state benefits received through a player's club program were not deductible from net win. However, a GCB memo states the definition of a wager is not clear, even in the more explicit 2007 compact language surrounding net win. The GCB contends a wager must be monetary value risked by a player, and free play credits do not fall under this definition. However, this definition of a wager is not stated in either compact.

Legislative oversight of tribal revenue sharing with the state is limited to payment confirmation only. LFC staff reviewed publicly available net win data and aggregate revenue share payment data to assess if tribes were fulfilling their revenue sharing obligations. This process including taking the net win for each tribe and calculating the expected revenue share payment based on the terms listed in the tribe's compact. While this yielded a total for each tribe, revenue share payment data cannot be released by tribe, so LFC staff then compared the sum of revenue calculations to the aggregate revenue share data publicly available. Within a margin of 0.31 percent, LFC staff determined tribes were accurately remitting revenue sharing based on their calculated net win, but this analysis cannot address how tribes calculate net win.

**Table 3. LFC Estimated Tribal Gaming Revenue Share
FY08-FY12**

Tribe	FY08	FY09	FY10	FY11	FY12
Acoma	\$3,223,175	\$2,335,429	\$1,670,694	\$1,655,747	\$1,687,470
Isleta	\$10,077,212	\$9,692,488	\$8,785,665	\$8,834,141	\$8,729,733
Jicarilla Apache	\$429,229	\$299,311	\$243,915	\$226,440	\$184,285
Laguna	\$9,768,626	\$9,610,516	\$9,171,650	\$9,474,455	\$9,126,268
Mescalero Apache	\$5,784,301	\$5,515,484	\$5,228,415	\$5,537,618	\$5,670,560
Navajo Nation	\$0	\$1,648,434	\$3,450,490	\$3,637,593	\$5,139,572
Ohkay Owingeh	\$2,358,241	\$1,906,463	\$1,608,450	\$1,493,040	\$924,397
Pojoaque	\$2,081,479	\$3,914,870	\$4,133,091	\$4,265,043	\$4,583,331
Sandia	\$16,452,165	\$16,058,169	\$15,785,692	\$16,679,419	\$17,537,897
San Felipe	\$1,896,410	\$1,715,315	\$1,705,128	\$1,819,980	\$1,761,455
Santa Ana	\$7,868,286	\$6,962,705	\$6,774,049	\$6,805,111	\$7,080,672
Santa Clara	\$2,332,558	\$1,960,794	\$2,078,184	\$1,942,893	\$2,109,204
Taos	\$581,971	\$537,000	\$468,608	\$491,014	\$469,053
Tesuque	\$2,848,980	\$2,241,003	\$2,001,099	\$2,074,690	\$2,064,496
Totals	\$65,702,633	\$64,397,979	\$63,105,131	\$64,937,184	\$67,068,394
Aggregate Revenue Share Payments	\$65,488,441	\$63,748,350	\$63,044,799	\$64,892,038	\$67,029,030
Variance	-0.33%	-1.02%	-0.10%	-0.07%	-0.06%

Note: Net win data made publicly available per terms of tribal gaming compacts used in this calculation. Revenue share data by tribe is confidential per compacts. LFC estimated revenue share totals based on net win and calculation parameters in the tribal gaming compacts. Regulatory fees were deducted from aggregate revenue share payments.

Sources: GCB/Tribal Gaming Compacts

The GCB has been in mediation with various tribes on revenue sharing calculations based on the treatment of free play promotions in calculating net win. As of the publishing of this report, only the Navajo Nation has settled their dispute.

Terms negotiated with the Navajo Nation for a new tribal gaming compact do not adequately address market oversaturation, free play, and availability of reporting. The governor entered into negotiations with all tribes signed onto the 2001 tribal gaming compacts in 2012. These tribes are the Pueblo of Acoma, the Jicarilla Apache Nation, the Mescalero Apache Nation, the Navajo Nation, and the Pueblo of Pojoaque. The current compacts these tribes are gaming under expire June 30, 2015.

Market erosion between tribal casinos and racetracks is a concern in renegotiating tribal gaming compacts. The draft Navajo Nation compact addresses competition with non-tribal class III gaming facilities by limiting hours of operation and number of machines at racetrack casinos, a change from the 2001 compact. The new compact authorizes the Navajo Nation to open two more casinos in addition to the three casinos currently operating, for a total of five. However, there is no mention in the compact language of geographic distance between current or future gaming facilities authorized for the Navajo Nation and current gaming operations of other tribes or racetracks. Based on location, both Acoma and Laguna Pueblos and Sunray Park Racetrack and Casino could be considered direct competitors of the Navajo Nation’s casinos. In testimony before the New Mexico Racing Commission, Sunray Park representatives stated they observed decreased gaming revenues as a result of the Navajo Nation’s casinos.

**Table 4. Tribal Gaming Net Win
FY08-FY12**

Tribe	Net Win Total					Average Net Win Growth FY08-FY12
	FY08	FY09	FY10	FY11	FY12	
Acoma	\$40,289,686	\$29,192,859	\$20,883,677	\$20,696,842	\$21,093,376	-48%
Isleta	\$103,356,024	\$99,410,129	\$90,109,382	\$90,606,579	\$89,535,728	-13%
Jicarilla Apache	\$7,865,360	\$6,241,393	\$5,548,938	\$5,330,499	\$4,803,560	-39%
Laguna	\$100,191,032	\$98,569,391	\$94,068,208	\$97,173,893	\$93,602,744	-7%
Mescalero Apache	\$72,303,767	\$68,943,552	\$65,355,189	\$69,220,223	\$70,881,996	-2%
Navajo Nation	\$0	\$20,605,421	\$43,131,130	\$45,469,909	\$64,244,646	212%
Ohkay Owingeh	\$25,494,492	\$20,610,411	\$17,388,647	\$16,140,971	\$13,371,864	-48%
Pojoaque	\$26,018,493	\$48,935,873	\$51,663,641	\$53,313,042	\$57,291,635	120%
Sandia	\$168,740,149	\$164,699,173	\$161,904,534	\$171,070,969	\$179,875,869	7%
San Felipe	\$20,501,733	\$18,543,943	\$18,433,821	\$19,675,455	\$19,042,760	-7%
Santa Ana	\$80,700,370	\$71,412,356	\$69,477,421	\$69,796,007	\$72,622,277	-10%
Santa Clara	\$25,216,841	\$21,197,769	\$22,466,858	\$21,004,254	\$22,802,209	-10%
Taos	\$9,669,955	\$9,183,779	\$8,444,414	\$8,686,638	\$8,449,226	-13%
Tesuque	\$30,799,788	\$24,227,056	\$21,633,499	\$22,429,079	\$22,318,873	-28%
Totals	\$711,147,690	\$701,773,105	\$690,509,359	\$710,614,360	\$739,936,763	4%
Change Year Over Year		-1.3%	-1.6%	2.9%	4.1%	
Sunray Race Track Gaming Revenues	\$40,136,901	\$39,184,932	\$40,258,959	\$40,322,163	N/A	N/A

Note: Navajo Nation net win growth measured for FY09-FY12 only. Sunray Park gross gaming revenues are not equal to net win, but net win data is confidential under the Gaming Control Act.

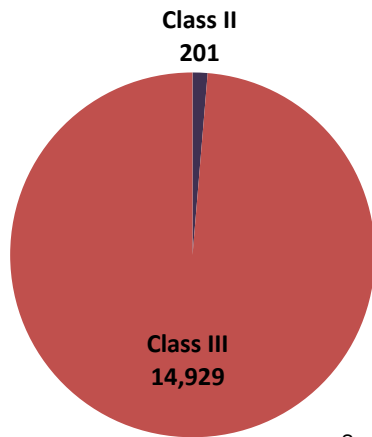
Source: GCB and NMRC

Overall net win at New Mexico tribal casinos between FY08 and FY12 has remained flat at an average of \$711 million (Table 4.) While new casinos have opened in that timeframe, overall gaming revenue has grown only 4 percent. Instead, revenues shifted among an increasing number of casinos, signaling oversaturation in the marketplace. With the limits being placed on non-tribal gaming as part of the draft Navajo Nation compact, it is reasonable to expect that new casinos will further erode market share at Sunray Park and casinos located within neighboring tribal lands.

The Navajo Nation draft compact takes steps to limit the growth of Class II gaming in tribal casinos. As gaming technology evolves, tribes might implement more class II gaming, which is not part of the revenue sharing agreement with the state. Language within the compact limits the number of Class II gaming machines the Navajo Nation can operate to 20 percent between all facilities. Florida put a similar requirement in its 2010 gaming compact with the Seminole Tribe, requiring the tribe convert 80 percent of its Class II gaming machines to Class III by January 2010, fully converting to all Class III machines by 2015 or the tribe would have to pay an additional premium to the state in their Class III revenue share.

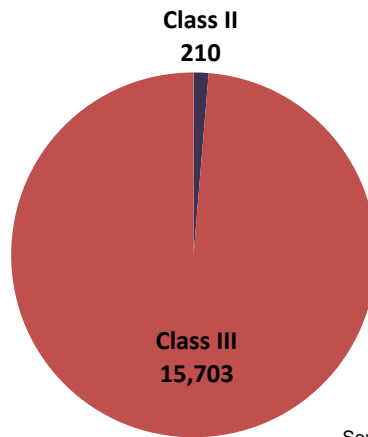
The GCB does not consistently track changes in Class II and III machine counts over time, making it impossible to enforce any limitations on Class II gaming growth. Currently, the GCB counts gaming machines at tribal casinos annually, distinguishing between Class II and Class III. However, the GCB does not track this data at the same point year over year, and has not retained data further back than June 2011. If the state intends to limit Class II gaming in future tribal gaming compacts, tracking changes in machine counts over time is imperative. The draft compact with the Navajo Nation does not specify how the Nation will report gaming machine counts to confirm the 20 percent limitation is being followed, making GCB enforcement of this provision unclear.

Chart 7. Tribal Gaming Machine Count FY11



Source: GCB

Chart 8. Tribal Gaming Machine Count FY12



Source: GCB

Draft compact language for the Navajo Nation introduces a new solution to free play revenue recognition which does not provide material benefit to the state. Treatment of free play has been a point of contention between the state and tribes for various years. The GCB in a legal memo claimed that various tribes had not been correctly calculating net win by improperly deducting prizes without including the value of played value, which in the case of free play promotions, would be the value of free play credits a player was awarded. As recently as November 2012, the GCB was in mediation with various tribes to try and resolve the disagreement on how free play should be addressed in calculating net win.

According to the draft 2013 Navajo Nation compact, the Nation settled its dispute with the state over free play in net win calculations and can move forward with a new gaming compact. The compact applies a new formula for determining what free play value should be included in an “adjusted net win.” This formula is not being used in any other state in addressing free play for revenue sharing payment calculation.

LFC staff tested the impact of including a portion of free play revenues in the net win calculation as stated in the draft 2013 Navajo Nation compact. Adding a free play component to revenue sharing, however, had little impact on increasing revenues to the state.

Table 5. Hypothetical Scenario Revenue Share Calculation

	Current Scenario (Navajo Nation Position in Arbitration)	2001 Compact (GCB Position in Arbitration)	2013 Proposed Compact	2013 Proposed Compact with Class II Gaming Deducted
Free Play:	\$1,300,000	\$1,300,000	\$1,300,000	\$1,040,000
Total Wagering:	\$70,000,000	\$71,300,000	\$71,300,000	\$57,040,000
Total Prize Payouts:	\$56,000,000	\$57,040,000	\$57,040,000	\$45,632,000
Allowed Deductions:	\$358,813	\$358,813	\$521,800	\$521,800
Adjusted Free Play:	N/A	N/A	\$357,482	\$285,986
Annual Adjusted Net Win:	\$13,641,187	\$13,901,187	\$14,095,682	\$11,172,186
Apply Revenue Share Calculation:	8.00%	8.00%	9.75%	9.75%
Revenue Share Payment Due:	\$1,091,295	\$1,112,095	\$1,374,329	\$1,089,288

Assumptions: Free play held at 2 percent of total wagering. Total wagering estimated with FY12 Navajo Nation net win as a basis. Total prize payout held at required 80 percent of wagering totals. Allowed deductions under 2001 compact is \$275,000 with a 3 percent growth rate from 2004-2012.

Source: LFC/GCB Analysis of 2001 Navajo Nation Compact and 2013 Proposed Compact

Provisions of the draft Navajo Nation compact do not fully address legislative oversight concerns. In contrast to the 2001 compact, the Navajo Nation compact includes language adding representatives of the Legislature to meetings between the state and the Navajo Nation once the compact is executed. While this allows for greater legislative involvement, the draft compact does not increase legislative oversight of compact compliance, as access to relevant reporting for the Legislature is not clearly stated.

GCB access to relevant tribal gaming data was renegotiated with the Navajo Nation. New Mexico tribal gaming compact language allows for access to gaming data electronically. The GCB has not exercised this option and relies on paper reports to monitor the compacts including net win calculations and revenue share payments. In contrast, Arizona has electronically access to gaming data, allowing more consistent and timely verification.

RECOMMENDATIONS

The Legislature should:

Exercise its authority under the Compact Negotiation Act to request negotiations with compacted gaming tribes to amend compacts to increase legislative oversight of tribal gaming in New Mexico through:

Creating stipulations for formal cyclical legislative review of tribal gaming and compact compliance by both the state and tribes and

Clarifying compact language to define which state entities can review tribal data (the GCB, the State Auditor, the Taxation and Revenue Department and the Legislative Finance Committee) subject to maintaining current confidentiality standards in the compacts.

Update language regarding confidentiality in the Gaming Control Act to allow the Legislature and the State Auditor access to reports and data to assess the GCB's oversight function with the requirement that confidential data not be made public;

Statutorily create an independent Office of the State Gaming Representative to avoid extended periods of vacancy in this position; and

Amend statute to create a process for a joint racing and gaming license for racetracks that will leverage resources at the GCB and the NMRC to vet racetrack operators annually, increasing transparency and reducing duplicative review and legal processes around the awarding of these licenses.

The GCB should:

Track and report to the Legislature counts of Class II and Class III gaming machines at a set time annually at minimum, and retain this data to track changes in machine counts over time; and

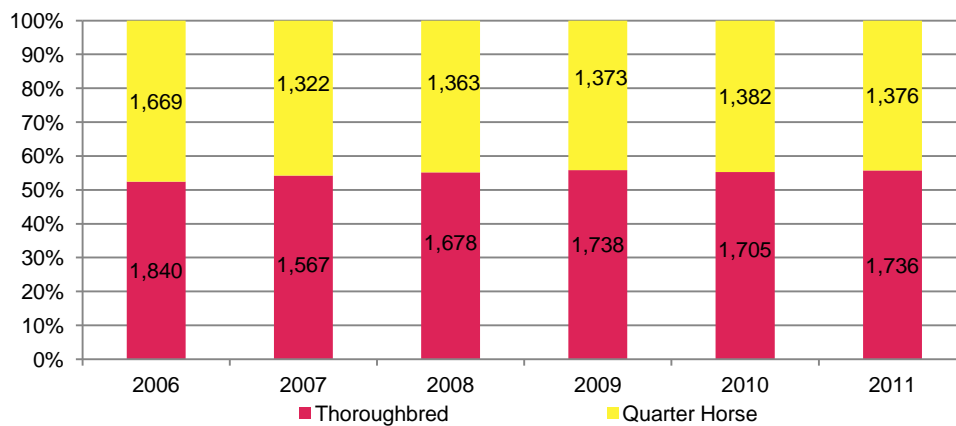
Segment work in the audit and enforcement divisions by risk factors and provide a minimum audit scope (audit annually or less frequently, on-site audit versus desk audit, etc.) to ensure all gaming entities are being adequately monitored and staff resources can be measured and deployed more effectively.

HORSE RACING HAS AN IMPORTANT ROLE IN NEW MEXICO’S ECONOMY, BUT FACES CHALLENGES IN THE CURRENT ENTERTAINMENT INDUSTRY LANDSCAPE.

The horse racing industry has examined various ways to increase interest in the sport and build sustainability. New Mexico has an extensive history in horse racing, dating back over 100 years. Horse racing is tied to many other agricultural industries in the state, including breeding, training, and veterinary science, among many others. According to an economic study conducted by the American Horse Council, the New Mexico horse industry produces \$503 million in goods and services and employees 35.7 thousand FTEs directly. The state’s horse population is 147 thousand, with over 60 percent involved in shows and other recreational activities. Therefore there is a vested interest in securing the health of the equine industry in the state of New Mexico.

The current mix of quarter horse and thoroughbred races does not reflect wagering interest at the state’s racetracks. New Mexico has a long history in quarter horse racing, and is one of few states that offer races for this breed of horse. Eastern states focus solely on thoroughbred racing. Currently, racetracks offer 60 percent thoroughbred races during racing meets as conditions allow.

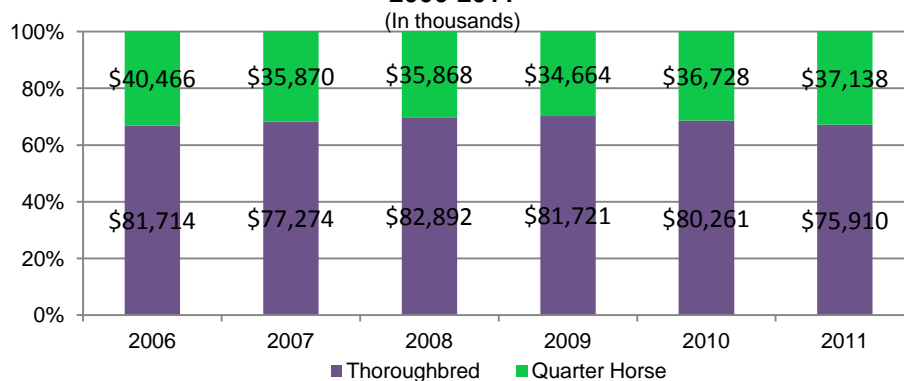
**Chart 9. Percentage of Races by Horse Breed
2006-2011**



Source: NMRC

However, wagering behavior indicates a greater interest in thoroughbred racing, with almost 70 percent of total wagering attributed to this one horse breed. The New Mexico Horseman’s Association and the New Mexico Horse Breeders Association have been in talks with racetrack owners to find ways to improve interest in racing, and among topics being discussed is increasing the number of thoroughbred races offered. Better matching race offerings to wagering behavior could have a positive impact on increasing attendance and wagering at New Mexico racetracks.

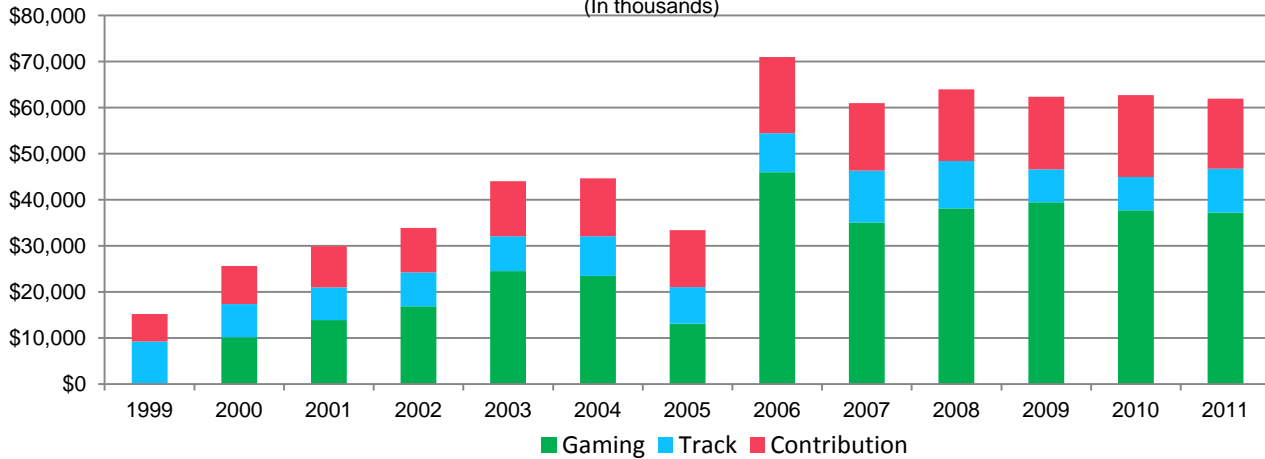
**Chart 10. Wagering by Horse Type
2006-2011**



Source: NMRC

Since being introduced in 1999, gaming revenues have become the greatest driver of increasing purse sizes for New Mexico horse races. From 1999 to 2011, gaming revenues from racetrack casinos grew over 50 percent of purses awarded in New Mexico horse races. The Gaming Control Act of 1997 requires racetracks operating casino games to contribute 20 percent of net revenues to race purses.

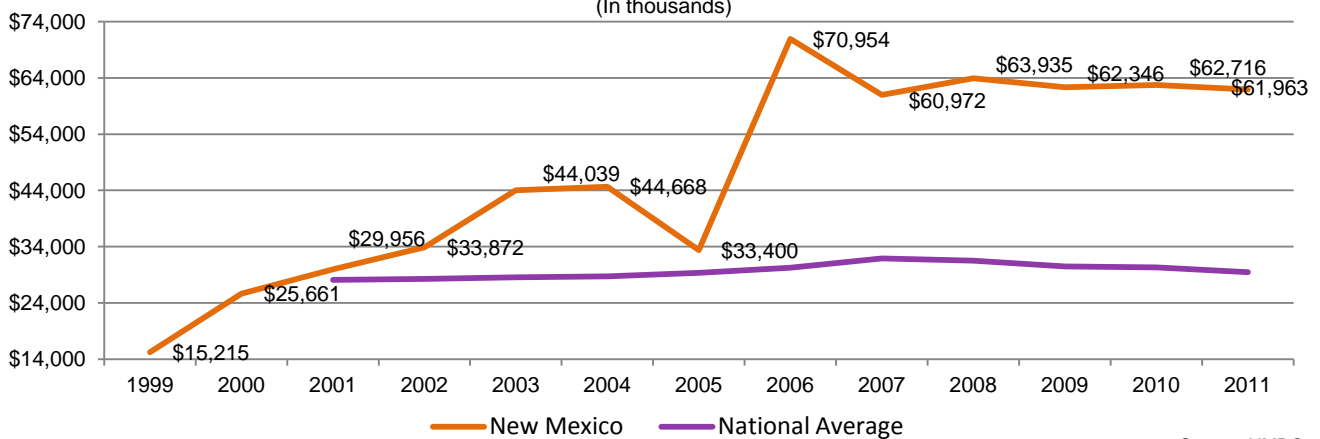
**Chart 11. Horse Race Purse Funding
1999-2011**
(In thousands)



Note: Contribution totals are funded by the New Mexico Horsemen's Association and the NM Horse Breeders Association.

Horse racing purse sizes grew a total of 274 percent per race between 1999 and 2011, far outpacing national averages. Changes to statute enabling gaming at racetrack casinos was intended to bolster the horse racing industry through increased attendance and wagering because of greater purses. Total horse race purses totaled \$15.2 million in 1999, an average of \$7,300 per race. Over the next 12 years, purses grew fourfold to \$62 million or \$20 thousand per race, reaching \$71 million in 2006. However, consistent with national trend, purses have leveled off after 2007.

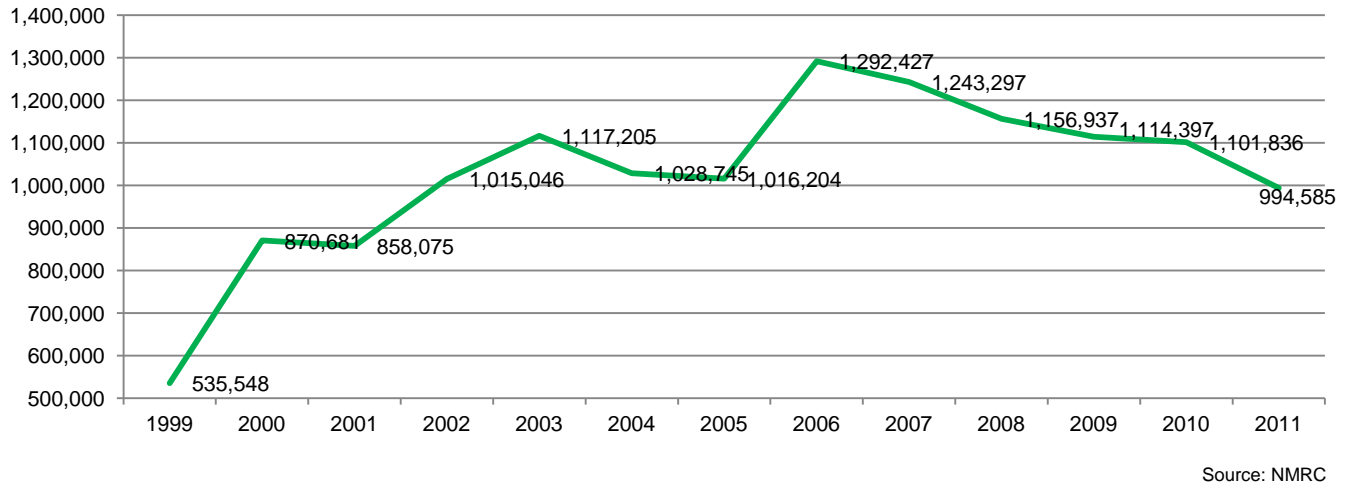
**Chart 12. Total Racing Purses
1999-2011**
(In thousands)



Source: NMRC

Even with increased purse amounts, horse race attendance has declined since 2006. While racing attendance has declined, net win at racetrack casinos is double the total wagered on New Mexico horse races.

**Chart 13. Total Racing Attendance
1999-2011**
(In thousands)



Casino gaming is a lower risk endeavor than operating live horse racing. Casino operations have a much lower overhead than live horse racing meets. For example, Sunray Park generated \$40.3 million in total gaming revenues, costing \$27.6 million, or 68 percent of revenues. To conduct live racing, Sunray Park spent \$2.5 million to generate \$299 thousand in revenues, a loss of \$2.2 million.

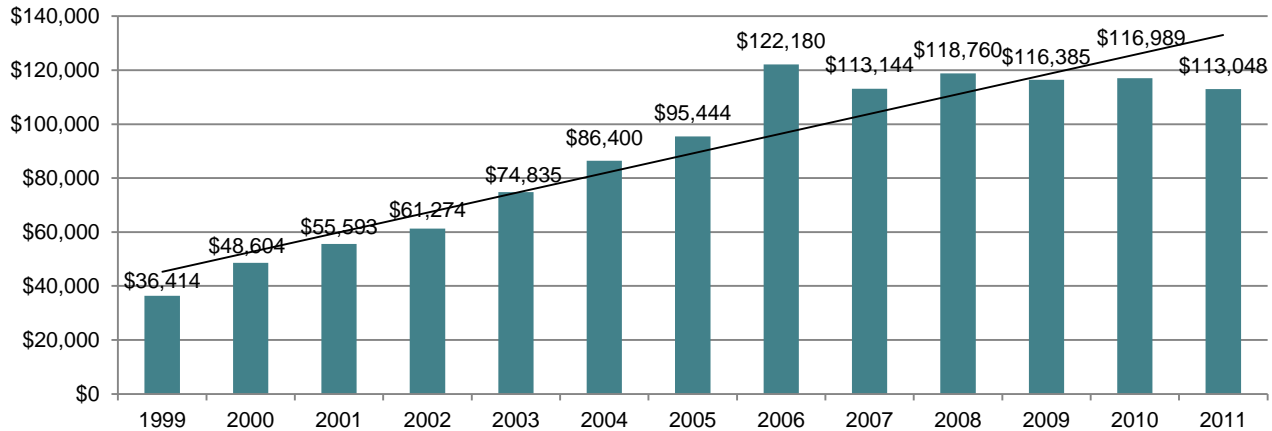
**Table 6. Racetrack Casino
Net Win
FY06-FY12**
(in thousands)

FY06	\$229,632
FY07	\$244,295
FY08	\$248,578
FY09	\$257,237
FY10	\$242,050
FY11	\$246,888
FY12	\$247,251

Source: GCB

Wagering at New Mexico racetracks has grown since 1999, but leveled off prior to the economic downturn. Average wagering per race also increased from 1999 to 2010 by an average of 7.6 percent. Wagering is impacted by attendance, and if attendance had experienced more consistent growth, wagering would have increased at a greater rate. In 2013, the Downs at Albuquerque announced plans to begin night racing to attract new customers.

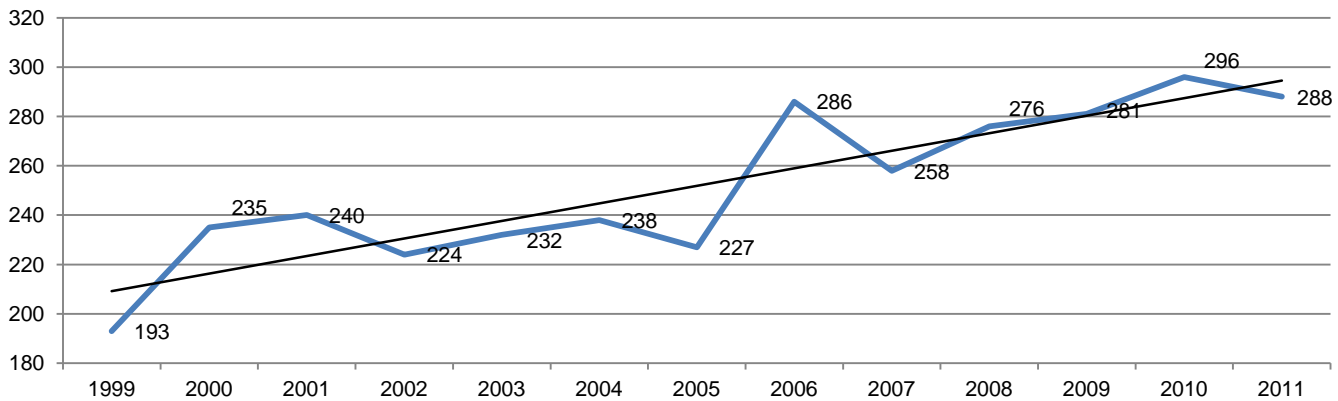
**Chart 14. Total Wagering
2006-2011**
(In thousands)



Source: NMRC

The number of race days at New Mexico racetracks has increased since the addition of gaming revenues to purses, but have decreased since 2006. Total race days have increased from 215 in 1999 to 288 in 2011, an average increase of 3 percent, even under downward pressure by losses incurred by operating live racing.

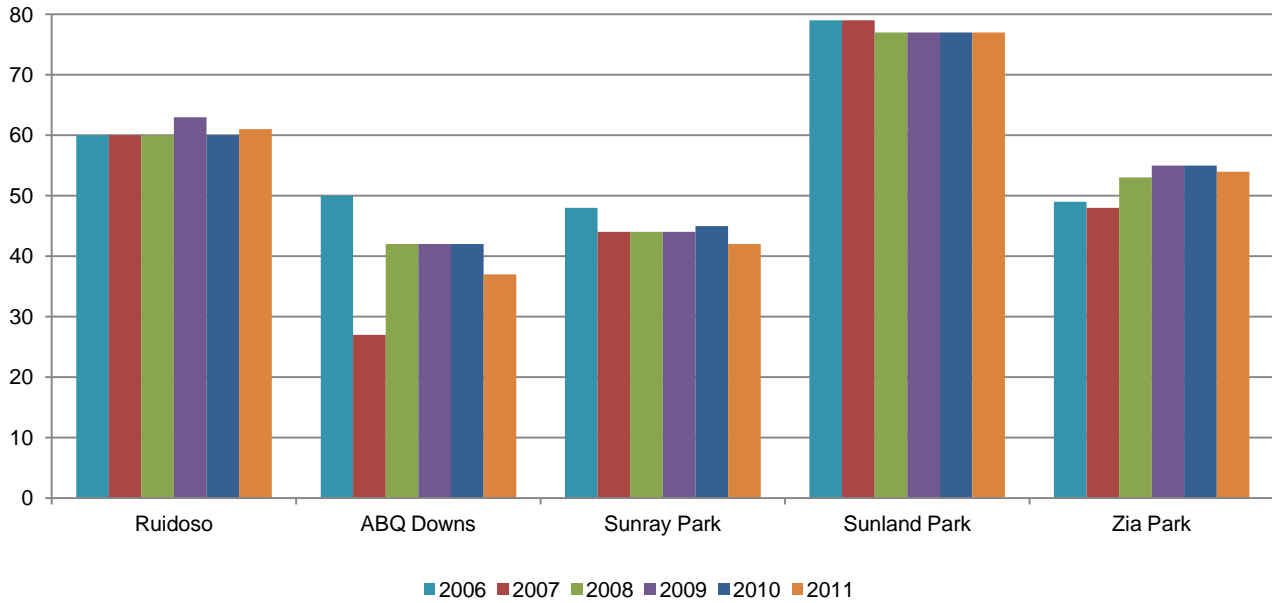
**Chart 15. Total Racing Days
1999-2011**



Source: NMRC

Racetracks submit suggested racing schedules with their annual license renewal and the NMRC determines the final race schedule. Statute mandates a minimum race meet of 17 days. The only operator to offer a meet at this minimum length is the New Mexico State Fair, as the Fair only runs at most 17 days.

**Chart 16. Race Days by Track
2006-2011**



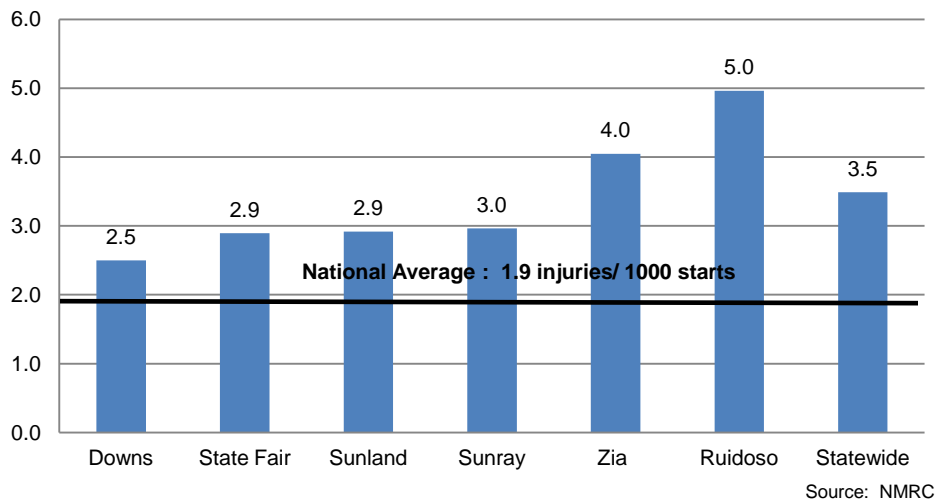
Source: NMRC

Colorado attaches race day requirements to their racetrack classifications, mandating a minimum number of 60 days of live racing for the higher class B racetrack designation. The NMRC assigns racetrack classifications based on gross wagering revenue, so attaching race day requirements based on gross wagering strength could be an option to remove risk of race day reductions.

WEAK AUTHORITY AND LIMITED STAFFING CAPABILITY HINDERS EFFECTIVE OVERSIGHT OF HORSE RACING IN NEW MEXICO.

The New Mexico Racing Commission faces significant challenges in bringing legitimacy back to the New Mexico horse racing industry. Consistent with reporting by the New York Times in 2012, horse fatalities in New Mexico are nearly double the national average. According to the Jockey Club Equine Injury database, based on 1.5 million starts at 29 tracks across the country, over the past four years the number of fatalities per 1,000 starts was 1.9. By comparison, from 2007 to 2011, New Mexico averaged 3.5 fatalities per 1,000 starts, with the highest fatality rates at Ruidoso Downs and Zia Park.

Chart 17. Fatalities per 1,000 Starts, 2007-2011

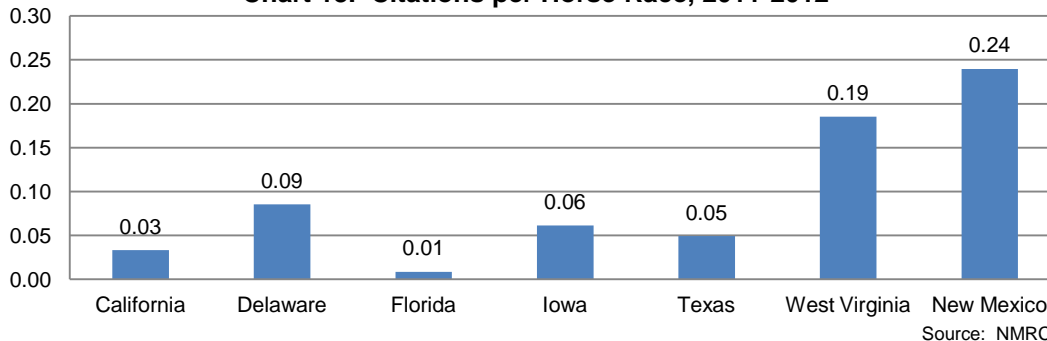


Of the 709 injuries reported between 2007 and 2012, 627, or 88 percent, resulted in death or euthanasia. Approximately 60 percent, or 412, of the 709 reported injuries were related to fractures; 82 were colic, nine were pneumonia, and five were heart attacks.

Improvements to surface conditions, such as Zia Park’s 2011 investment of \$80 thousand into its track, can help reduce injuries and fatalities. Both nationally as well as in New Mexico, however, administration of illegal performance-enhancing and pain-reducing drugs more often threaten rider and horse safety.

While the NMRC issues a relatively high number of citations per horse race, fine amounts are lower than many other states and may not serve as sufficient deterrent to cheating. Of the seven states with reported data, New Mexico issued the greatest number of citations per race, 0.24.

Chart 18. Citations per Horse Race, 2011-2012



In 2011, New Mexico levied more fines than any state with the exception of California, although California ran seven times as many races as New Mexico. By comparison, Texas, with the same number of dedicated investigators and running three times as many races in a calendar year as New Mexico, issued 138 fewer citations and levied \$21 thousand less in fines.

Table 7. Selected States' Horse Racing Enforcement

State	Year	Number of Investigators (FTE)	Number of Citations/ violations	Number of licenses suspended / revoked	Fines Levied	Number of races per year	Average Fine	Citations per Race
California	2011	16	950	0	\$218,630	28,642	\$230	0.03
Delaware	2012	2	77	27	\$28,212	900	\$366	0.09
Florida	2012	18	452	27	\$49,875	52,527	\$261	0.01
Iowa	2012	3	52	1	\$6,760	850	\$130	0.06
Texas	2012	5	277	1	\$57,375	5,618	\$207	0.05
New Mexico	2011	3	415	7	\$78,625	1,731	\$189	0.24

Source: State Racing Commissions

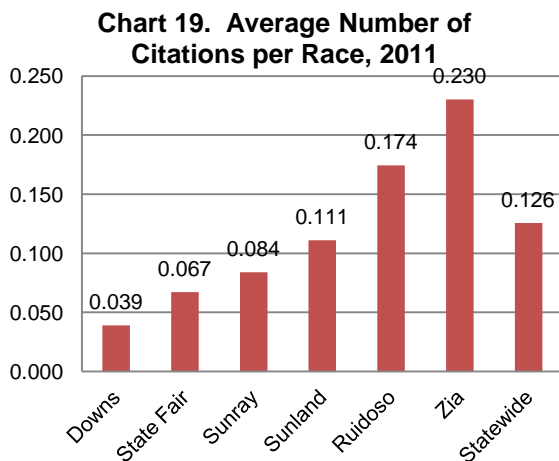
The number of fines levied in New Mexico has not correlated with track safety. In 2011, while the statewide average fine was \$189, the highest average fines, \$405, were collected at Sunray Park; Sunland Park, the track with the most races, had the highest total amount of fines, \$22,900.

Table 8. New Mexico Racetrack Fines, 2011

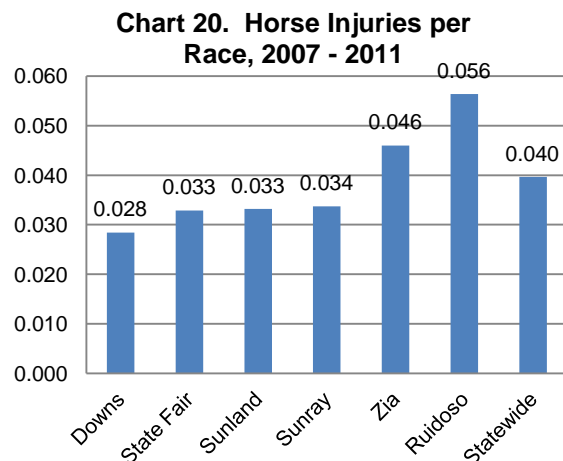
Racetrack	Number of Races	Number of Fines	Total Amount	Average Fine
Downs at Albuquerque	541	21	\$4,100	\$195
Ruidoso Downs	619	108	\$12,800	\$119
State Fair	194	13	\$1,500	\$115
Sunland Park	882	98	\$22,900	\$234
Sunray Park	488	41	\$16,600	\$405
Zia Park	582	134	\$20,725	\$155
Total	3,306	415	\$78,625	\$189

Source: NMRC

Zia Park's average citation per race of 0.23 was the highest in the state, nearly double the state average of 0.13 citations per race. At the same time, the number of horse injuries at Zia Park per race was 0.05, also higher than the state average of 0.04. Similarly, the Downs at Albuquerque has both the lowest number of fines per race at 0.04, as well as the lowest number of horse injuries per race at 0.03.



Source: NMRC



Source: NMRC

With the low fine amounts compared with purse sizes and the lack of lifetime bans, the state’s penalty structure for violations is weak, although recent legislation makes significant improvements. New Mexico’s current statutory penalties do not exceed \$10 thousand for a single violation of the Act, drug or otherwise, and no language addresses the possibility of a lifetime ban. When compared with an average purse size in 2011 of \$20 thousand, a maximum \$10 thousand fine is not as significant as fines levied in other states. For example, the New Jersey Racing Commission has the authority to levy a maximum fine of \$50 thousand per violation, and the Delaware Harness Racing Commission fines up to the total purse awarded.

The NMRC recently reactivated its membership with the Association of Racing Commissioners International (ARCI), which recommends a minimum \$10 thousand fine for a first offense and a \$50 thousand minimum fine for the 3rd lifetime violation using a Class A drug. With the passage of Laws 2013, Chapter 103 (Senate Bill 444), the NMRC now has the authority to levy fines up to a maximum of \$100 thousand or the total purse amount, whichever is greater. The fiscal impact report for Senate Bill 72 (Laws 2013, Chapter 102), which established penalties to be tied to ARCI standards, identified concerns with pegging NMRC penalties specifically to ARCI model rules, which could preclude the option of stronger standards from other national organizations.

Other states perform more frequent equine drug testing than New Mexico. The Association of Racing International has identified various states that perform more equine drug testing than New Mexico. The state of New York performs the most tests per race with an average of 6.5 tests across all race types including at least the first through fourth place finishers, as well as another random participating horse. The average among the other 32 states the ARCI surveyed is between three and four tests per race (**Appendix D.**) New Mexico currently tests only the winning horse and one other horse, which is the least amount of testing among surveyed horse racing jurisdictions. The NMRC has a goal of testing four horses per race, which would move New Mexico into the top tier of states for testing. ARCI does not offer a recommendation for how frequently racing commissions should perform equine drug testing, nor have any other entities such as the Jockey Club or the National Thoroughbred Association addressed this issue. Similar to determining track safety by measuring changes in horse breakdowns per 1000 starts, racing commissions such as the NMRC will have to determine the correct level of equine drug testing based on changes in prevalence of positive drug tests as they increase total testing.

Additionally, the Jockey Club Thoroughbred Safety Committee recommended horses not residing on racetrack property be subject to pre-race drug testing. This practice could be beneficial to the NMRC in addressing horses coming onto licensed racetracks after participating in illegal racing activities.

The NMRC has not received sufficient appropriations to increase equine drug testing frequency at New Mexico racetracks. Based on a two-year average of equine testing cost per race for the NMRC, it would cost \$722 thousand to test the winner and one additional horse per race, and \$1.1 million to test the winner plus two additional horses per race as noted below:

Table 9. Forecasted Equine Drug Testing Costs

2-Year Average Cost per Test	Testing Winner +1 (per race)	Testing Winner +2 (per race)	Testing Winner +3 (per race)
\$210	\$419	\$629	\$838

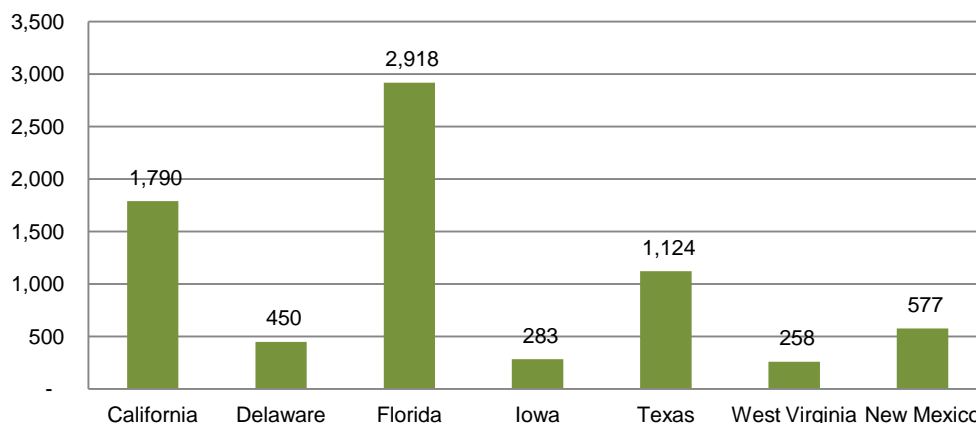
FY10-11 Number of Races per Year	Testing Winner +1 (per race)	Testing Winner +2 (per race)	Testing Winner +3 (per race)
1,722	\$721,574	\$1,082,361	\$1,443,147

Source: LFC Analysis of NMRC Data

The NMRC also hopes to perform out-of-competition testing but has not stated the frequency of this random testing. The 2013 Legislature created an equine testing fund of \$350 thousand for FY15 and \$700 thousand for FY16 forward from pari-mutuel tax revenues that were going to capital outlay bonds at Expo NM. However, this fund alone is insufficient to perform the level of drug testing the NMRC would like to achieve with five racetracks. The NMRC requested a \$400 thousand funding increase over the FY13 operating budget for contractual services, with 87 percent of this increase being directed to equine testing. However, the NMRC did not provide information on how the agency arrived at this increased request amount or how it planned to deploy the additional resources. The 2013 General Appropriations Act included a \$210 thousand increase for contractual services.

New Mexico lacks sufficient investigators to monitor statutory compliance at racetracks during live race meets when compared to other states. For the seven states listed below, the average investigator oversees 1,024 races. Florida averages the most races per investigator, 2,918, while New Mexico averages 577 cases per investigator. In 2011, New Mexico had three full-time investigators, while as of February 2013, the state had four positions with only two filled. While statute requires investigators at tracks at least four days per week, given the current number of filled positions, one investigator is generally at each track two to three days per week. In contrast, California reports having three investigators as well as one supervising investigator present during a live race meet.

Chart 21. Races per Investigator, 2011 - 2012



Source: State Racing Commissions

The New Mexico Racing Commission (NMRC) struggles to address illegal horse racing occurring in New Mexico. A KRQE investigative report about illegal racing in New Mexico highlighted the NMRC’s inability to regulate these tracks. The NMRC confirmed in LFC and House Appropriations and Finance Committee (HAFC) testimony this year that statute gives the commission jurisdiction over licensed tracks only. However, statute dictates “it is a violation of the Horse Racing Act for a *person* to hold a public horse race or a race meet for profit or gain in any manner unless the person has been issued a racetrack license by the commission and has been authorized by the commission to hold the horse race or race meet on specific dates.” Therefore, races conducted without a license, regardless of location, are a violation of the Horse Racing Act, but enforcing the Act based on identifying who is operating the illegal race meet may be difficult. The NMRC testified in HAFC that they are partnering with the New Mexico State Police to address illegal racetracks.

Exhibit 1. Photos from KRQE Report on Illegal Horse Racing



Source: KRQE Larry Barker Investigation, November 7, 2012

The Arizona Department of Gaming (ADG) successfully shut down illegal racetrack activities in Pinal County following an anonymous tip in 2012. Evidence collected by undercover agents suggested violations including conducting a criminal enterprise, promoting and benefiting from gambling and possession of gambling devices. While ADG does not have jurisdiction over horse racing in Arizona, this example shows that other agencies can assist racing commissions based on what state law defines. The NMRC could leverage potential partnerships with other agencies such as the GCB in addressing illegal racetracks. The New Mexico Gaming Control Act states possession of a gaming device without a license or controlling a place where such devices are located is a violation of the Act.

NMRC enforcement officers are not certified, presenting concerns over training and safety while on duty at New Mexico racetracks. NMRC investigators are required by statute to not carry firearms, but must have basic law enforcement training. In testimony in front of the LFC, the NMRC has expressed concern that in light of criminal activity occurring at racetracks in the state, enforcement staff is not adequately prepared. Previous LFC briefs, as well as national press coverage, have spoken to various levels of criminal activity occurring at legal and illegal New Mexico racetracks. The NMRC is concerned about their officers operating in potentially dangerous environments

while carrying out their oversight duties, but the NMRC does not track criminal incidents that occur on licensed racetrack premises, and was only able to provide anecdotal data about concern over staff safety at racetracks.

Other states have differing stances on arming racing commission agents, with Delaware tending to hire retired law enforcement, but choosing not to certify them. The Delaware Thoroughbred Racing Commission prefers to pursue sanctions administratively, and not be limited by investigatory protocols that come with officer certification. The Texas Racing Commission, on the other hand, employs certified peace officers. GCB agents are certified and armed, stating this assists in building partnerships with local law enforcement and facilitates transferring cases for prosecution. Certifying NMRC enforcement officers would require additional training and potentially present issues with recruiting similar to what the GCB is experiencing. As an alternative, other law enforcement resources could be leveraged with the Department of Public Safety (DPS), combining the NMRC's specialized knowledge on horse racing issues and the DPS's law enforcement capabilities. This partnership already occurs annually when the New Mexico State Fair contracts with the State Police to be on site during the Fair, which includes a horse racing meet for 17 days.

Inaccurate data and a lack of oversight activities impede the New Mexico Racing Commission from effectively enforcing the Horse Racing Act. The NMRC uses reports from racetracks and audits from contracted auditors performed during live race meets to monitor gross revenues from pari-mutuel wagering, which totaled over \$113 million in FY11 alone, and oversees compliance with payment of all taxes associated with horse racing in New Mexico.

Pari-mutuel wagering taxes paid to the state by racetracks are self-reported, and are not audited by the NMRC on a regular basis. The NMRC requires taxes paid to be audited during live race meets by their contracted auditors, and confirmed to the LFC that they randomly check tax revenues at other points in the year as well. The Taxation and Revenue Department (TRD) does not track these tax dollars, so the NMRC becomes the de facto enforcement entity to ensure racetracks are abiding by state law in payment of pari-mutuel taxes. Audit reports provided to the NMRC by contracted audit firms show finalized calculations of taxes, but do not show how these figures were verified, and totals appear to tie to audited revenues during live race meets only. LFC staff reviewed reports the NMRC receives from racetracks year-round providing revenue and tax information, but these reports are not currently designed to easily audit tax payments for accuracy. This hinders the NMRC's ability to oversee proper tax payment by racetracks for the majority of the year.

In contrast, the GCB calculates taxes due and generates statements to racetrack casino licensees on a monthly basis from their central monitoring system (CMS). Revenues reported through CMS are audited daily and tax statements rarely have to be amended. Gaming tax payments are then made directly to the TRD by licensees. Removing the self-reporting element from racetrack tax payments would ensure accuracy and protect the state's interests in pari-mutuel wagering.

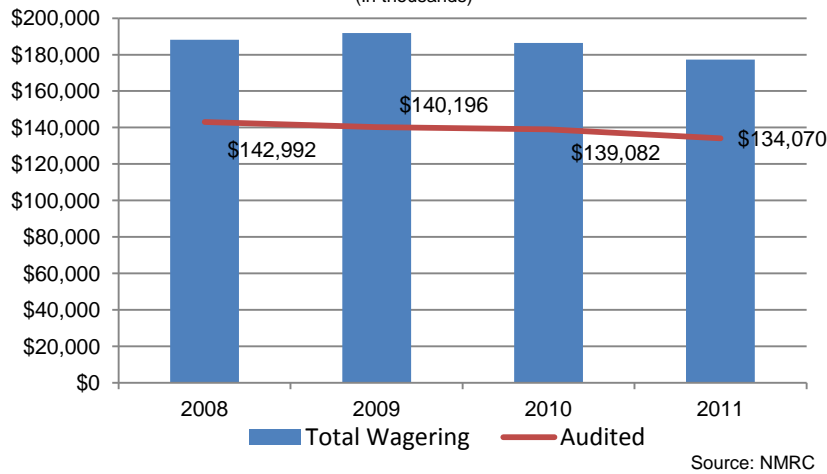
The NMRC has not effectively monitored racetrack classifications to ensure tracks are properly designated and are following related statutory obligations. Taxes paid by New Mexico racetracks are dictated by classifications designated in statute. Class A racetracks must meet a requirement of having \$10 million in gross wagering revenue in the preceding calendar year, while class B racetracks must generate less than \$10 million in gross wagering revenue for the same time period. Furthermore, statute dictates that a new racetrack be classified based on estimated gross wagering revenue, and the NMRC should reassess the classification assigned after the first year of racing. Class A racetracks pay \$650 daily in pari-mutuel taxes for live racing and \$300 daily for days where only simulcast wagering is conducted. Class B racetracks have a lower live racing pari-mutuel tax of \$300 for each racing day. Class B racetracks are also allowed under statute to take a deduction from daily capital outlay taxes for promoting horse racing in the state, in addition to deductions for capital improvements that all racetracks are allowed.

Zia Park racetrack was not properly classified under statute as a Class A racetrack with over \$10 million in pari-mutuel wagering, a requirement that Zia Park met after its first year of operation in 2005. Zia Park's classification

was not adjusted until 2011, five years after the classification should have been reassessed. This misclassification led to Zia Park paying less pari-mutuel and capital outlay taxes to the state. With a state appeals court authorizing the release of the sixth racetrack license in March 2013 for new applications, proper classification of a new racetrack will be relevant again.

The NMRC only requires audits of revenues and taxes from racetracks during live racing meets, which leaves 25 percent of wagering revenues unaudited. Between 2007 and 2011, simulcast only race days accounted for 81 percent of total pari-mutuel wagering days. Simulcast in-state wagering revenues outside of live meets, which are taxable, are not audited by the state. Simulcast wagering revenues in 2011 alone accounted for 57 percent of total wagering revenues, of which only one third were audited. Complete auditing of simulcast revenues would also ensure that pari-mutuel taxes are paid correctly.

Chart 22. Total Wagering vs. Audited Wagering Revenues FY08-FY11
(In thousands)



Reported totals of gaming revenues reallocated to support horse racing purses vary greatly between the NMRC and the Gaming Control Board (GCB). The GCB’s totals for these revenues were reported at higher levels for the entire period racetrack casinos have been in operation, with one year the GCB reporting more than double the gaming purse distribution that NMRC reported.

Table 10. Aggregate Gaming Revenues Designated for Horse Racing Purses
(In thousands)

CY	GCB Data	NMRC Data	Difference
1999	\$2,308	\$0	-\$2,308
2000	\$15,264	\$10,182	-\$5,081
2001	\$17,586	\$13,918	-\$3,667
2002	\$23,135	\$16,893	-\$6,241
2003	\$30,160	\$24,510	-\$5,649
2004	\$29,431	\$23,514	-\$5,917
2005	\$34,866	\$13,120	-\$21,746
2006	\$45,926	\$45,952	\$25
2007	\$48,859	\$35,082	-\$13,777
2008	\$49,716	\$38,153	-\$11,562
2009	\$51,447	\$39,432	-\$12,015
2010	\$48,410	\$37,723	-\$10,687
2011	\$49,378	\$37,252	-\$12,126

Source: GCB and NMRC

The NMRC was unable to confirm the cause of this discrepancy. Casino gaming was legalized in New Mexico to bolster the horse racing industry, and racetracks are responsible for ensuring that the correct amount of revenues are transferred from gaming operations to the horseman's trust accounts for racing purses. GCB data is downloaded directly into their central monitoring system from gaming machines in racetrack casinos, and the 20 percent allocated to horse racing purses is calculated from this data. GCB auditors also review these transfers as part of their audit protocol. The NMRC may be relying on self-reporting of these revenues from racetracks, which could indicate a risk for these funds not being correctly credited to horseman's trust accounts, a violation of state law. Deductions for administration costs can be taken from interest earned on these revenues, but should not create a variance between the totals the GCB is reporting should be allocated for racing purses, and what the NMRC confirms was actually transferred. The NMRC and GCB should cross-audit these revenues to ensure accuracy, but currently do not do so.

Review of provided financial statements for racetracks licensed to operate through the NMRC shows two racetracks are not adequately capitalized. The Downs at Albuquerque reported in their 2011 financial statements a deficit in shareholder's equity of \$3.9 million, and carry forward losses of \$10.4 million. Additional paid in capital of \$6.4 million helped to offset the sizeable deficit, but the Downs still maintained a negative shareholder's equity position. Furthermore, at year-end the Downs had \$963 thousand cash on hand. Outstanding debt notes totaled \$5.5 million, of which \$3.1 million was owed to shareholders who lent funds to the Downs to be repaid in 2013. Having a negative debt to equity ratio of 210 percent indicates that the Downs is extremely overleveraged, which should be a concern in awarding a racing license to the venue.

Ruidoso Downs finds itself in a similar situation, carrying forward a \$17.8 million loss against shareholder's equity. Though shareholders have provided additional capital totaling \$18.9 million as of December 2010, total shareholder's equity was \$4.9 million. In 2011, Ruidoso Downs reported a net loss of \$679 thousand. Total liabilities equaled \$2.4 million, which calculates to a debt to equity ratio of 49 percent. Ruidoso's current liabilities of \$1.8 million include unsecured debt which can be called by the debt holders at anytime. This debt could be considered high risk, as Ruidoso Downs ended 2011 with only \$759 thousand cash on hand.

Section 60-1A-11 NMSA 1978 states that a license applicant must be sufficiently capitalized pursuant to standards set by the commission to conduct the business covered by the license. New Mexico Administrative Code 15.2.2.8 does not address the overall financial health of a racetrack licensee, instead requiring that the track have sufficient funds to pay purses, and a surety bond to cover these obligations must be issued payable to the NMRC. However, not assessing the total financial stability of a racetrack creates potential risk to the industry in New Mexico if these racetracks are unable to meet their debt obligations and are forced to cease operations. This also raises concerns about continuing to award licenses with zero contingencies to financially unstable racetracks.

A lack of adequate IT resources and knowledge hinders the NMRC's ability to regulate horse racing activities. The NMRC regulates horse racing across the state of New Mexico offering licensing for 58 different race-related activities. Remoteness of track locations, the short turnaround time sometimes required in issuing licenses, and the ability to enforce disciplinary action taken at racetracks makes having adequate IT resources essential.

The NMRC faces significant challenges in effectively regulating due to outdated IT resources and a lack of IT staff. Licensee data is maintained on an older Access database, and licensing offices at active racetracks lack the ability to transfer licensee application data to the NMRC and vice versa except through the physical transport of data on flash drives between racetracks and the NMRC. This impedes the timely update of licensee data. NMRC staff in Albuquerque and at racetracks are also working off of dated information and cannot assess the status of licensee applications in real time.

Furthermore, the NMRC has no IT staff of its own, and relies on IT support from the GCB to maintain its current functionality. The GCB does not charge the NMRC for these services, but not having dedicated IT support has

impacted the NMRC's ability to remain current and aware of licensee issues that would impact future licensing efforts and oversight. In contrast, the Regulation and Licensing Department (RLD) uses online tools and has offered these services to a variety of licensing boards in the state, facilitating access to data and streamlining the licensing process.

Racing licenses are most often approved on-site at racetracks, where licensing clerks do not have access to data that could render an applicant ineligible. These cases have to be addressed after the license has been awarded through administrative action, which can be time consuming and have additional costs. Access to real-time records on racing license applicants would reduce burden of repealing licenses awarded incorrectly. IT upgrades like wireless hotspot devices and remote network access could greatly assist the NMRC in addressing licensing and enforcement issues at racetracks, and may reduce costs.

Improving the New Mexico Racing Commission's database could increase the state's ability to monitor safety and enforcement. In its current form, it is difficult to extract specific safety information, such as number of citations by track, amount of fines, or types of violations from the NMRC's licensing database. Revising the database to a more standardized format would allow easier access to a variety of oversight reports. Along with other states, the New Mexico Racing Commission is currently developing a new safety and enforcement database with the Association of Racing Commissioners International, and the NMRC received a special appropriation of \$67.5 thousand in the 2013 General Appropriations Act to fund this database.

RECOMMENDATIONS

The Legislature should formalize in statute:

Future updates to equine doping penalties not be tied solely to recommendations from the Association of Racing Commissioners International (ARCI), but to any prevalent industry-accepted oversight organization to allow flexibility in adopting best practices;

The NMRC's role in addressing illegal racing in New Mexico, whether it be providing oversight or administrative support to other law enforcement agencies, or if the NMRC alone should have full jurisdiction over investigating this activity;

The NMRC's role in remediating racetracks with high horse breakdown rates by:

Granting the NMRC power to determine when a track requires intervention;

Establish a remediation plan to be supervised by the NMRC or their contracted representative;

Require reporting on progress and at completion of any remediation projects; and

The authority for the NMRC to put contingencies on license renewals of tracks with high financial risk or poor safety records.

The NMRC should:

Enter into a Joint Powers Agreement with relevant state agencies such as the Department of Public Safety and the Gaming Control Board to enforce current statute and criminal code in addressing illegal racetracks in New Mexico;

Partner with other licensing agencies such as the Regulation and Licensing Department or the Gaming Control Board to identify potential IT solutions to assist in managing licensure data remotely and electronic record keeping;

Complete a budgetary plan for increased equine drug testing including frequency of race and out-of-competition testing, anticipated costs and funding sources (such as increases to licensing fees) to be included in the agency's FY15 budget request;

Report back to the Legislature with a proposal to bolster enforcement of the Horse Racing Act to be included in the agency's FY15 budget request including:

- Documentation of crimes committed at New Mexico racetracks;

- Process to obtain certified officer status for enforcement staff to carry firearms, including associated costs of certification;

- FTE increases to allow for two enforcement officers at minimum to be on track during live meets;

- Alternative solutions such as contracting with the New Mexico State Police;

Institute a monthly reconciliation process of pari-mutuel revenues that results in the production of a tax bill for payment of pari-mutuel and capital outlay taxes to the Taxation and Revenue Department, similar to the current process at the Gaming Control Board with a process to confirm payment was made; and

Cross-audit data on gaming revenues designated for purses with the Gaming Control Board to validate proper transfer of these revenues.

NEW MEXICO RACING COMMISSION



April 29, 2013

Mr. David Abbey, Director
 Legislative Finance Committee
 325 Don Gaspar Avenue Suite 101
 Santa Fe, New Mexico 87501

Susana Martinez
 Governor

Robert M. Doughty III
 Chairman

Re: New Mexico Racing Commission's response to LFC Operational Effectiveness of Gambling Oversight in New Mexico.

Beverly Bourguet
 Vice-Chairman

Thank you for allowing the NMRC this opportunity to respond to the Legislative Finance Committee's Evaluation Report by Maria Griego. Ms. Griego was very thoughtful, responsive and professional during the evaluation process. We appreciate the research and analysis that was conducted by the members of the evaluation team.

Ray Willis
 Member

After a review of the evaluation, the New Mexico Racing Commission respectfully submits the following comments and suggestions as our official response:

Gayla McCulloch
 Member

- 1. The current mix of quarter horse and thoroughbred races does not reflect wagering interest at the state's racetracks. Pg. 10*

Jerald G. Cospers, DVM
 Member

In 2012, A group made up of members of the New Mexico Racing Commission, New Mexico Horseman's and Breeders Association met to discuss the possibility of Split Race meets of Thoroughbred and Quarter Horses at New Mexico Horse Race Tracks.

Vince Mares
 Executive Director

Changing the structure of a race meet changes a lot of dynamics, including Stake schedules and simulcast contracts along with the composition of the jockey colony. Most importantly we must think about the fan base and how separate meets will affect tourism. There are a lot of dynamics to consider.

The group plans to meet again this year to further discuss the issue.

2. The New Mexico Racing Commission faces significant challenges in bringing legitimacy back to the New Mexico horse racing industry.
Pg. 15

The focus of the NY Times article was on illegal doping, not on the accidents. Granted, the article did elaborate on the high rate of accidents in New Mexico, but it also made clear that it is the doping of horses, and the lack of enforcement of the rules that has led to these accidents.

Additionally, the article claimed exaggerated rates for accidents in New Mexico. Not every accident that was reported by the Times was a horse that had to be euthanized. In fact, the New Mexico Racing has an extremely cautious policy which allows horses to be taken off the track (vanned off) if the jockey, during the race, suspects any problems at all. That means that many of the horses that were reported as accidents are alive and well and still racing.

What steps has the newly appointed Racing Commission taken to address the drug problem? The new Commission has taken an increasingly tough stand on illegal doping. Since the Commission has been appointed in the middle of 2011, they have been handing out penalties to trainers that dope their horses. In fact, this Commission has been known to suspend trainers for several years for drugging the horses.

New Mexico is the first state to ban the use of Clenbuterol in both Quarter Horses and Thoroughbreds (i.e. – only microscopic trace amounts of Clenbuterol are allowed in a horse on race day. The threshold level is based on California’s rule banning Clenbuterol in Quarter Horses). The Commission found that Clenbuterol, intended to be used as a therapeutic drug to help horses’ breath (i.e. bronchodilator), was being abused as a performance enhancing drug because it acts as a steroid. The Racing Commission determined that the Clenbuterol use was out of control in New Mexico. Currently the use of Clenbuterol is prohibited 30 days prior to a horse running. New Mexico Racing Commission has received national support on its suspension of Clenbuterol.

Additionally, the Racing Commission has implemented a new necropsy program. In instances of a suspicious death of a race horse, the remains of the horse are sent to the Department of Agriculture (VDS) in Albuquerque to be necropsied to determine cause of death. Currently the NMRC is contracted with UC Davis as our equine testing lab. UC Davis is the only lab in the country that is RMTTC (Racing Medication Testing Consortium) accredited.

3, While the NMRC issues a relatively high number of citations per horse race, fine amounts are lower than many other states and may not serve as sufficient deterrent to cheating. Pg. 15

The commission identified within the rules, areas that needed revisiting. One area was the lack of uniformity in the penalties handed down against licensees for infractions of the administrative code. There was substantiated data that required the commission to adopt a policy and penalty chart that was consistent with national horse racing standards. In July of 2012, the NMRC adopted the Association of Racing Commissions International (ARCI) Penalties. This penalty system is a guide that allows the NMRC to issue penalties that are consistent with racing jurisdictions throughout the country.

With the adoption of the ARCI penalties, the State Racing Commission was still bound by the \$10,000.00 penalty cap for violations of the rules. Legislation was introduced to remove the \$10,000.00 penalty cap. On April 02, 2013, Governor Martinez signed Senate Bill 444 which allows the commission to impose civil penalty fines upon a licensee for a violation of the provisions of the Horse Racing Act or rules adopted by the commission. The fines shall not exceed one hundred thousand dollars (\$100,000) or one hundred percent of a purse related to the violation, whichever is greater, for each violation.

4. The NMRC has not received sufficient appropriations to increase equine drug testing frequency at New Mexico racetracks. Pg.18

The budgeted amount for equine testing has decreased since 2010. In fiscal year 2010 the NMRC received \$403,235.10, fiscal year 2011 was \$317,450.00 and fiscal year 2012 was \$370,000.00. With a decreased budget, the agency has had to cut back in their number of horses being tested.

Legislation was introduced in the 2013 Legislative Session to seek addition funding for Equine Testing. On April 02, 2013, Governor Martinez signed Senate Bill 72 "RACEHORSE TESTING FUND. The "racehorse testing fund" is created in the state treasury. The purpose of the fund is to ensure the testing of racehorses at a laboratory that meets or exceeds the current national laboratory standards for the testing of drugs or other foreign substances not naturally occurring in a horse, as established by the association of racing commissioners international, incorporated. The fund consists of one-half of the daily capital outlay tax appropriated and transferred pursuant to Paragraph (4) of Subsection A of Section 60-1A-20 NMSA 1978 and

appropriations, gifts, grants and donations made to the fund. Income from investment of the fund shall be credited to the fund. The commission shall administer the racehorse testing fund, and money in the fund is appropriated to the commission for the handling and testing of blood serum plasma, urine or other appropriate test samples taken from racehorses pursuant to Section 60-1A-14 NMSA 1978. Any unexpended or unencumbered balance remaining in the racehorse testing fund at the end of a fiscal year in excess of six hundred thousand dollars (\$600,000) shall revert to the general fund.

5. The New Mexico Racing Commission (NMRC) struggles to address illegal track horse racing occurring in New Mexico. Pg. 19

NMRC enforcement officers are not certified, presenting concerns over training and safety while on duty at New Mexico racetracks. Pg. 20

The New Mexico Racing Commission and the New Mexico State Police has been in discussion to address the Illegal Bush Tracks. As written in the LFC report, the NMRC does not have certified law enforcement personnel. NMRC investigators have jurisdiction only within the confines of the racetrack itself. The entire dynamics of the racing investigators would have to change if they are asked to investigate the suspected bush tracks.

First and foremost there would have to be a statutory change that would give the commission statewide jurisdiction. With statewide jurisdiction the agency would fall under the New Mexico Public Safety Act which would mandate that all commissioned investigators MUST be certified within one year. The commission currently staffs 4 investigators. These investigators will have to attend a six month basic law enforcement academy located in Santa Fe, New Mexico.

Secondly there needs to be a revision of the Racing Act that outlines Illegal Horse Racing. The way the current statute reads was an obstacle that caused the dismissal of bush track case that was investigated by the NMSP in 2008. The commission would need additional funding for required equipment for certified law enforcement officers along with an increased investigative staff. Investigations such as bush tracks require extended periods of covert undercover operations in order to obtain the needed evidence to successfully prosecute the case. Additionally, because of Mexican Cartel influence at these bush tracks, specialized teams (i.e. S.W.A.T) would be needed as part of the commission's investigative authority.

The best approach to address the bush track issue is to have the NMRC work in conjunction with a law enforcement entity. Either the local, county or state law enforcement agency would investigate the criminal aspect of the bush track, while the NMRC would assist in the administrative prosecution of any NMRC licensees.

6. *Inaccurate data and a lack of oversight activities impede the New Mexico Racing Commission from effectively enforcing the Horse Racing Act. Pg.20*

The NMRC has not effectively monitored racetrack classifications to ensure tracks are properly designated and are following related statutory obligations. Pg. 21

The NMRC only requires audits of revenues and taxes from racetracks during live racing meets, which leaves 25 percent of wagering revenues unaudited.pg.21

Reported totals of gaming revenues reallocated to support horse racing purses vary greatly between the NMRC and the New Mexico Gaming Control Board (GCB). Pg.21

Review of provided financial statements for racetracks licensed to operate through the NMRC shows two racetracks are not adequately capitalized. Pg.22

The NMRC uses reports from racetracks and audits from contracted auditors performed during live race meets to monitor gross revenues from pari-mutuel wagering, which totaled over \$113 million in FY12 alone, and oversees compliance with payment of all taxes associated with horse racing in New Mexico. The agency relies on these contracted audits to ensure compliance with our statutory requirements.

The NMRC concurs with the LFC's findings that the Taxation and Revenue Department (TRD) does not track these tax dollars, so the NMRC becomes the de facto enforcement entity to ensure racetracks are abiding by state law in payment of pari-mutuel taxes. Audit reports provided to the NMRC by contracted audit firms show finalized calculations of taxes, but do not show how these figures were verified, and totals appear only to tie to audited revenues during live race meets. This method hinders the NMRC's ability to oversee proper tax payment by racetracks for the majority of the year.

The NMRC respectfully requested in the 2013-2014 budget proposals the approval of an in house auditor position. Our justification for this request was to oversee the statutory financial oversight. We have had and continue to have concerns of this oversight prior to the LFC's findings. The agency would like to mirror an in house auditor position such as the one found in the Gaming Control Board. Our request for the position was denied; therefore the NMRC has no choice but to continue using contractual audit services.

In Closing the New Mexico Racing Commission recognizes the hard work of LFC's staff in producing this evaluation and in developing its recommendations. Thank you for the opportunity to review and respond to this report.

Respectfully,
Vince Mares Executive Director



Susana Martinez
Governor

Jeffrey S. Landers
Board Chair

May 3, 2013

Mr. David Abbey, Director
Legislative Finance Committee
325 Don Gaspar, Ste. 101
Santa Fe, NM 87110

**Via Email – David.Abbey@state.nm.us
and First Class Mail**

**Re: Legislative Finance Committee Report
New Mexico Racing Commission
Gaming Control Board
Operational Effectiveness of Gambling Oversight in New Mexico**

Dear Mr. Abbey:

We are in receipt of the above-referenced document ("LFC Report") by email at 4:55 PM on April 17, 2013 providing the agency with a deadline of April 26, 2013 to provide its response to the LFC Report. The Gaming Control Board ("GCB") utilized its best effort to provide a response to the LFC Report within the seven (7) business days it was allotted. The GCB requested an extension to permit an additional five (5) business days to complete its response. The LFC Staff rejected this request and provided only a three (3) business day extension despite the fact that the GCB advised that the author of the response the Executive Director and the Audit and Compliance Division Director had previously scheduled a trip to Phoenix, Arizona on May 1 that would take them out of the office all day. Despite providing this information, the LFC Staff would only agree to provide an additional two(2) days to provide the response. The GCB felt that it was more prudent to provide a full and complete response than to cut its response short simply to meet the LFC Staff's arbitrary deadline for assembling binders for the hearing. This response was emailed to the LFC Staff on May 3, 2013 at 2:30 PM.

A. THE GAMING CONTROL BOARD'S AUDIT AND COMPLIANCE DIVISION IS A WELL EDUCATED, WELL TRAINED AND VERY EXPERIENCED GROUP OF DEDICATED EMPLOYEES.

The GCB's Audit and Compliance Division is constituted of the following positions:

- 1 - Audit and Compliance Division Director
- 2 - Audit Managers
- 8 - Gaming Auditors
- 1 – Administrative Assistant

The Audit and Compliance Division Director is a Certified Public Accountant and a Certified Management Accountant who holds an MBA degree from the Stern School at NYU and has more than twenty (20) years of audit experience. The Audit Managers have a combined twenty-one (21) years of experience in auditing gaming operations. One of the Audit Managers holds an MBA and is a Certified Fraud Examiner. Five (5) of the Gaming Auditors are Certified Fraud Examiners, one other staff member holds an MBA degree and another holds a Juris Doctor degree. The Gaming Auditors have a combined forty-seven (47) years of experience auditing gaming operations. While the Gaming Auditors are assigned to an Audit Manager overseeing either Racetrack Casinos or Non-Profit Gaming, all of the Audit and Compliance Division Auditors are cross trained to audit Racetrack Casinos and Non-Profit Gaming and to conduct Compliance Inspections of Tribal Gaming operations. The purpose of cross training the Gaming Auditors is to allow the greatest amount of flexibility in terms of resource allocation and utilization as issues arise in each segment of the gaming industry in New Mexico. Division Management may, and does, assign Gaming Auditors to all three (3) types of gaming operations regardless of the Audit Manager to whom they are regularly assigned.

While the Audit and Compliance Division could utilize additional staff, the employees always take sufficient time to conduct thorough audits, compliance reviews and tribal inspections.

B. THE GCB SPENDS A SIGNIFICANTLY GREATER AMOUNT OF ITS TIME AUDITING RACETRACK CASINOS THAN NON-PROFIT ORGANIZATIONS.

The LFC Staff incorrectly reports that the GCB audits non-profit gaming operations at a higher frequency than any other type of gaming operation. The LFC Report assumed that every audit conducted by the GCB takes the same amount of time and utilizes the same level of staff resources. However, the LFC Analyst conducting the review never asked the GCB's Audit and Compliance Division:

1. how it conducts the audit for each segment of the gaming industry;
2. the number of employees assigned to perform an audit for each segment of the gaming industry;
3. the number of days that an audit team is at the gaming operation performing an audit.

With respect to the percentage of time dedicated to field work for each category of gaming operation the Audit Managers report that for FY12 the breakdown is as follows:

Racetrack Casinos	- 46.5 %
Tribal Gaming	- 29.6 %
Non-Profit	24.9 %

1. Racetrack Audit – Staffing, Time and Scope

When the GCB audits a Racetrack Casino it sends a team of 4-5 employees to the gaming operation and the audit takes place over a period of four (4) days in the field, with staff working ten (10) hour days. The audit scope includes, but is not limited to the following activities:

1. Review/Verification of Daily Slot Accounting Systems Reports
2. Review of Payouts – Slips, Cage Reports, SAS Reports
3. Overage/Shortages
4. Vault Transfers
5. Unclaimed Jackpots
6. Bank Reconciliations

7. Machine and Facility Licenses
8. ATM Placement
9. Override Review
10. W-2Gs (Tax Reporting Compliance)
11. Responsible Gaming Expenditures (Proper Application of Funds)
12. Bank Account Activity and Reconciliation Review
13. Vault Inventory and Procedure Review
14. Horsemen's Purse (Accuracy and Timing of Payments)
15. Gaming Taxes (Accuracy and Timing)
16. Review of funds from Drop (Count procedures, Transfer of Funds, Deposit)
17. Review of Compliance with previous Reports
18. Financial reporting, General Ledger, Accounts Payable, financial analysis
19. Machine counts, review of casino signage and floor observation
20. Signature cards, position changes, separations, key control
21. Title 31 compliance, suspicious activity reports
22. Self exclusion and CSED lookup/confiscation controls.
23. Promotional and marketing activities

2. Tribal Compliance Review – Staffing, Time and Scope

When the State Gaming Representative, with the assistance of Audit and Compliance Division staff, performs an annual inspection of each Tribe's Gaming Operations the review team is typically comprised of five (5) individuals and that compliance review takes place over a period of 1 to 2 days in the field. The scope of the compliance review includes, but is not limited to the following activities:

1. Verification of Net Win Calculation, including confirmation of all deductions.
2. Review of sample days, which are traced to Slot Accounting System Reports and the Revenue Sharing calculation.
3. Review of Promotions including free play and progressives.
4. A review of drop and counts for all sample days including tracing drop to receipt in the vault.
5. A review of payouts for 4 sample days.
6. Counting of machines
7. Review of revenue share calculation treatment of participation payments
8. Verification of non-financial compliance items included in Section 4 of the Compacts
9. Inspection and testing of ATMs

3. Non-Profit Audits - Staffing, Time and Scope

When the GCB audits a Non-profit gaming operation it assigns one staff member to conduct the field audit. When scheduling field audits, the Gaming Auditor typically plans 1 to 2 days in the field and travels to a location that has multiple non-profit gaming operators. The relatively short time it takes to do a field audit is made possible as a result of the GCB's receipt of monthly data regarding financial transactions from each non-profit gaming operator. The field audit scope includes, but is not limited to the following work:

1. Verification of bank signature cards
2. Verification of employment, employment changes and gaming signature cards
3. Review of Compulsive gambling training log
4. Review of key control and accounting lock box security
5. Security of documents and record retention

6. 100% review of two sample months of gaming paperwork
7. Drop, count, funds disposition and bank deposits
8. Tax payments and minimum tax bank account balances
9. 100% review of charity deposits, disbursements and supporting documentation
10. Evaluation of charity disbursements to ensure compliance with the GCA and GCB rules
11. W-2G and CSED forms for payouts in excess of \$ 1,199.99
12. Overages and shortages
13. Cash handling procedures
14. Security of check stock and pre-signed checks
15. Bank statements for all three gaming accounts
16. Allowable Gaming Expenses
17. Reconciliation to CMS
18. Verification of distributor payments for accuracy, timeliness
19. Segregation of duties
20. Cashier and vault counts
21. Training and answering licensee questions

C. GCB's OVERSIGHT, AUDIT, COMPLIANCE AND ENFORCEMENT IS ALL BASED ON A "RISK ASSESSMENT" FOR EACH CATEGORY OF GAMING OPERATION.

1. GCB Regulations Concerning Audit Frequency and Basis for Audits.

The GCB is assessing whether amendments to the current regulations addressing audit and compliance reviews are necessary. The GCB had not previously established set intervals for the frequency of audit and compliance reviews in order to provide discretion to the professional audit and compliance staff to schedule audits in those areas where special circumstances and situations would arise. In addition, the GCB did not want to impose restrictions on the audit and compliance staff that would eliminate the ability of the audit staff to perform random and unannounced audit and compliance review work of gaming operations.

Between 2006 and 2013, to date, there have been 12 embezzlement and 2 burglary prosecutions arising out of illegal conduct at non-profit gaming locations. In the table presented on page 3 of the LFC report, non-profit venues accounted for 42.7% of inspections and 40% of all criminal cases, while racetracks accounted for 40.5% of inspections and 29.3% of all criminal cases. Embezzlements at Non-profit venues have totaled in excess of \$100,000 in the last 7 years. There were 2 embezzlements cases at non-profits in 2005 that totaled \$190,000. One of these embezzlement cases included attempted arson charges as the individual, in an attempt to cover his tracks, set paperwork on fire at the lodge. As recently as January, the GCB uncovered two new instances of embezzlement at Non-profit licensees.

Thus, while the total gaming tax dollars generated by gaming is the smallest at the Non-profit locations, historically this segment of the industry has had the highest amount of crime associated with the industry. The GCB, long ago, recognized this fact and has tailored its audit process to address this very serious issue.

Because the GCB has multiple contacts with its licensees, through licensing, enforcement and audit activities, the agency in 2009 developed an internal list of "at-risk" Non-profit gaming operators. The purpose of developing the list was to focus the Gaming Auditors' and Enforcement Officers' attention on potential risks and problem areas. Additionally, the GCB offered to provide additional training and education to these gaming operators to assist them in meeting their compliance obligations as enumerated in the Gaming Control Act and the GCB's Gaming Regulations.

2. The Chart on Page 4 of the LFC Report Evidences that the Audit and Compliance Division Performed 151 Audits/Tribal Compliance Reviews in FY 12.

The LFC Report demonstrates that the GCB Audit and Compliance Division performed 151 audits or Tribal compliance reviews in FY 12. It is difficult to understand why the LFC Report attempts to advise the Committee that the GCB only performed 120 regular audits and 2 ad hoc audits in FY 12 when the data presented to the LFC staff and the chart on page 4 of the Report clearly demonstrated that the true number is 151.

3. Veteran, Fraternal and Non-Profit Gaming Operations

The GCB's audit and oversight of gaming operations is absolutely based on risk factors. The GCB has an intimate knowledge and understanding of the gaming industry in New Mexico. In considering the amount of resources to dedicate to the veteran, fraternal and non-profit gaming operations the GCB considers:

1. the primary purpose of gaming at these facilities is to provide sufficient income for the organizations to do charitable works in their communities and to have the financial means to continue to exist in their communities;
2. the relatively low level of training and experience of the Gaming Managers and Gaming Accountants (many of whom are volunteers or individuals who are retired and have no prior gaming experience but have agreed to help their organizations);
3. these operations have less sophisticated security systems and oversight of cash handling, deposits and financial transactions at the gaming facility;
4. these operations have less detailed and sophisticated internal controls;
5. the operation is limited to 15 gaming machines;
6. only members of the organization may play the machines; and
5. the history of embezzlement, theft, etc over the course of the last decade.

As a result of this risk assessment, the GCB has adopted a "follow the cash" approach when building its audit and compliance program. In order to reduce these risks the GCB has in place the following audit and compliance program:

1. monthly oversight of funds by obtaining financial documents such as bank statements, monthly drop paperwork, all charitable disbursement information and reports from the Central Monitoring System while tracking these documents and financial entries to observe patterns of conduct and to look for unusual or suspicious activity;
2. one field audit per year (taking approximately 4 hours per gaming operation);
3. one desk audit per year (taking approximately 6 hours per gaming operation);
4. random unannounced visits by Enforcement Agents to check to insure proper controls are in place and being observed with respect to cash handling related to gaming. These visits include surprise counts of cashier drawers and the vault, review of the day's paperwork, review of the security of the check stock and security of the accounting lock box. These items are in addition to the normal random inspections of surveillance systems, patron ID's and physical security;
5. education and training programs for the gaming operations and those people who are responsible for working in the gaming operations at these organizations.

It should be noted that until approximately 2008, the GCB conducted four (4) field audits per year at each of the veteran, fraternal and non-profit gaming operations. After conducting its own review of the results of such audits and evaluating the cost of travel and staff time in 2009, the GCB altered its audit process to the current system. It should be noted that budget constraints for the period FY09 and FY10 resulted in the GCB having to eliminate the annual field audit because the GCB did not have adequate funds in its budget to pay for travel costs such as fuel, maintenance, mileage and per diem. When the GCB received additional funding in FY11, it resumed the annual field audits. In order to address enforcement and compliance issues in a manner that was both efficient and effective, the GCB Audit and Compliance Division, the GCB Enforcement Division and the GCB Information Systems Division worked together to cross-train Enforcement Officers residing in the various quadrants of the State in cash handling procedures, and the most common issues related to gaming machine operations in order to allow for faster response times for patron disputes or unusual activities and to permit random and unannounced reviews of the gaming operations. All of this could be done without the need to pay mileage and per diem, gas and maintenance on vehicles that would be required, for staff located in Albuquerque, to travel to the various quadrants of the state.

Historically, this segment of gaming has experienced the highest level of criminal activity related to the gaming operation. The GCB has assisted various district attorney's offices with the prosecution of criminal cases related to embezzlement or theft by gaming employees. Accordingly, while the total tax dollars generated by the non-profit gaming segment is the lowest of all types of gaming operations, the GCB is required to pay close attention to this segment in order to protect the integrity of the industry, the tax dollars to be paid to the State of New Mexico, and the more than \$2 million dollars that is distributed to charitable causes.

4. Racetrack Casinos

The only similarity between Veteran, Fraternal and Non-Profit Gaming and Racetrack Casino gaming is that the GCB serves as the primary regulatory body for these entities. In evaluating the risks associated with a Racetrack Casino gaming operation the GCB considers that:

1. the Racetrack Casinos have sophisticated, professional and well-trained employees managing and running the gaming operation;
2. they possess robust Information Technology systems, including slot accounting systems, security and surveillance systems that monitor and report all activity including activities that occur on individual gaming machines;
3. they have GCB approved Minimum Internal Control Standards that are much more stringent than those adopted by the GCB for the less sophisticated and much smaller scale veteran, fraternal and non-profit gaming operators;
4. they possess far greater financial resources to address business needs and sophisticated access controls over systems and access and control points in the casino;
5. they have large permanent vaults and internal control processes that address cash movement as well as vault access controls;
6. the Racetrack Casinos do not face the same restrictions as to customers that are in place for non-profits;
7. there is no limit to jackpot size; and
8. racetrack casinos possess a profit motive in the operation of their gaming establishments; and
9. the GCB's Central Monitoring System allows the GCB to very accurately determine tax amounts due from these licensees and helps ensure that gaming taxes are paid timely and that racing purse contributions are correct and transferred in accordance with statute and regulations.

As a result of this risk assessment, the GCB has adopted an audit and compliance program that considers these issues and eliminates the risk associated with each category. In order to reduce these risks the GCB has in place the following audit and compliance program:

1. Two (2) on sight compliance audits annually (see scope above);
2. Three (3) to four (4) enforcement inspections monthly;
3. Participation of Enforcement Officers as team members during all field audits;
4. Pre-review of all promotions to be offered by the licensees;
5. Monthly verification of Gaming Tax payments through Taxation and Revenue Department;
6. Monthly review of all deductions taken against net win; and
7. Tracking of all previous audit findings and violations to ensure corrective action.

5. Tribal Gaming

The authority retained by the State of New Mexico to oversee Tribal Gaming operations is much different from the oversight authority for Racetrack Casino and Non-profit gaming operators. The Legislature created the GCB as the primary regulatory and oversight agency for Racetrack Casino and Non-profit gaming operators. However, in approving the Tribal-State Gaming Compacts the Legislature has positioned the GCB, by and through the State Gaming Representative, as a second line of regulatory oversight. That oversight is limited by the Compacts to reviewing Class III gaming documentation as it relates to the payment of revenue sharing and compulsive gambling contributions as required by the Compacts. Additionally, the GCB is permitted to review documents to insure that the Tribes that operate casinos have put in place those laws and procedures addressing the matters identified in Section 4 of the Compacts and to review documents to determine that the Tribal Gaming Agency is ensuring compliance with the obligations relative to the operation of the gaming facility and the express terms of the Compact. By the express terms of the New Mexico Gaming Control Act and the Compacts, the State of New Mexico is permitted to monitor and inspect the Tribal Gaming Operations but is **NOT** permitted to audit the tribal operation.

Accordingly, the risk assessment that takes place with respect to the Tribal Gaming operations is different from that applied to other types of gaming operators. The GCB is not permitted to inquire and review information that it would if it were the primary regulatory body that insures the integrity of this type of gaming operation. That role is left to the Tribal Gaming Agency and, in some limited and specific areas such as licensing or approval of tribal gaming ordinances, the National Indian Gaming Commission. Thus the State Gaming Representative in conjunction with the Audit and Compliance Division has identified the following areas of risk:

1. Underpayment of revenue share;
2. Deduction of items such as non-cash prizes that are not permitted by the Compacts;
3. Possibility of machine payouts lower than 80%;
4. Promotional activities that may result in improper deductions or payouts;
5. Lack of consistency between source documents and reports to the State;
6. Failure to timely pay revenue share; and
7. Existence of non-compliant gaming devices.

As a result of this risk assessment, the GCB has adopted a compliance inspection program that considers these issues and addresses the risks associated with each category. In order to reduce these risks the GCB has in place the following audit and compliance program:

1. Quarterly verification of payments to the State Treasurer;

2. One (1) annual on sight Inspection (see scope above);
3. Review of revenue share calculations and deductions;
4. Annual inspection and counting of gaming machines;
5. Verification of regulatory fee payments; and
6. Review and copying of slot accounting Statistical Net Win reports.

D. REPRESENTATIVES OF THE GCB MET WITH EXECUTIVE AND MANAGEMENT LEVEL EMPLOYEES AT THE ARIZONA DEPARTMENT OF GAMING TO DISCUSS METHODS OF IMPROVING AUDIT, INSPECTION AND OVERSIGHT OF GAMING OPERATORS.

On May 1, 2013, the Chairman, Interim Executive Director, and Audit and Compliance Division Director of the GCB travelled to Phoenix, Arizona to meet with members of the Arizona Department of Gaming. The purpose of the trip was to exchange ideas and information related to compliance reviews and exchange of data between a state and a Tribal Gaming Operation.

1. Arizona Department of Gaming Overview.

The Arizona Department of Gaming is the regulatory body that oversees Tribal Gaming in Arizona. The agency has 105 employees. The agency is funded through gaming revenue as a result of specific language in the Tribal-State Gaming Compact. Pursuant to the terms of the AZ Compact, the agency receives the first \$8 million in gaming revenue or 9%, whichever is greater. The Executive Director advises that this funding approach allows the agency to have consistency in its approach to regulating gaming inasmuch as the agency does not have to be concerned that tight budget cycles will disrupt operational requirements as a result of a reduction in general revenue funding.

The agency regulates only Tribal Gaming Operations and the Problem Gambling Program for both casino gaming and the Arizona Lottery. The Problem Gambling Program is funded through a combination of tribal gaming contributions and very limited funding from the Arizona Lottery. The program includes education and treatment components.

2. Paperless Audit and Risk Management Tools.

The meeting proved to very useful in a number of respects. First, the GCB was able to receive a demonstration of the paperless audit and risk management software system that the AZ Department of Gaming utilizes to plan and perform its inspections. The GCB has already contacted software manufacturers to discuss pricing, planning, implementation and training for the system. It is the GCB's hope that the system will be operating and tested on some smaller gaming operations by the end of the calendar year and fully utilized in Calendar Year 2014.

3. AZ Department of Gaming Has Limited Access to Electronic Data for Five (5) of Six (6) Rural Gaming Tribes.

The LFC Report at page 9 suggests that the AZ Department of Gaming is able to electronically access gaming data for all of the Tribal Gaming Operations in the state. This is an incorrect suggestion. The AZ Department of Gaming, only recently, obtained the ability to access (on a read only basis) the slot accounting system reports for five (5) of six (6) rural gaming tribes. The Tribes and the AZ Department of Gaming also worked out MOUs with the Gaming Tribes to work through issues related to security, limiting access to two (2) computers and two (2) employees with specific IP Addresses in order to safeguard the data and the proprietary and confidential nature of the information. Essentially, the AZ Department of Gaming is accessing the types of reports that are identified in the 2013 Amended Navajo Compact.

The GCB, in 2010, had established this very system for accessing the slot accounting system at one of the Tribal Gaming Operations. After the system was implemented and utilized for a limited period of time, there was a change in the composition of that tribe's gaming commission. As a result of the change in the gaming commission, the requirements and permissions needed to be able to access the tribe's slot accounting system were so burdensome that the agency was unable to pull the reports at frequent enough intervals to make the information relevant. Accordingly, the program came to an end. The State Gaming Representative will begin discussions with the Tribal Gaming Agencies to determine whether MOUs can be reached with the Tribal Gaming Operators to assist the SGR in confirming information related to the calculation of net win.

4. Additional Reporting Related to Tribal Contributions.

In Arizona, the Tribal Gaming operations make quarterly tribal contributions to the AZ Department of Gaming for distribution to mitigation funds provided for in the Compact. On a monthly basis, the tribes provide a revenue report to the Department of Gaming along with source documents to support the information in the report. The GCB will be working with the SGR to develop a similar reporting program with respect to the New Mexico gaming tribes. The AZ Department of Gaming will be providing the SGR with various templates that it has developed to track gaming revenue and reports. The GCB believes that this additional information will be of great value in monitoring gaming revenue at tribal operations and will assist in ensuring that the State of New Mexico is receiving correct revenue share payments each quarter.

5. AZ's Enforcement Officers and NM Enforcement Officers.

As the LFC Report indicates the AZ Department of Gaming has ten (10) Enforcement Officers for 21 Tribal Casinos, while the GCB only employees five (5) Enforcement Officers. The AZ Enforcement Officers are required to review surveillance systems, security protocols and operations for 21 tribal casinos with approximately 14,325 Class III gaming machines, as well as table games. The NM Enforcement Officers have no ability to review these systems or operations in the NM Tribal Gaming facilities.

The five (5) NM Enforcement Officers perform these same types of enforcement activities in the five (5) racetrack casinos that are currently operating a total of approximately 2544 gaming machines. In addition, they perform the same activities, on a much smaller scope, at the non-profit gaming facilities who, cumulatively, are currently operating approximately 646 gaming machines.

Based on the nature of the gaming operations, it appears as though the GCB's Enforcement Division is staffed at sufficient levels to protect the integrity of gaming in New Mexico. Should the State of New Mexico and the Tribal Gaming Operations agree to permit greater inspection and oversight by the GCB's Enforcement Officers in future Compacts, the GCB will ask for additional staffing to meet those expanded responsibilities.

E. THE "SILO APPROACH" OF USING GAMING AUDITORS SOLELY FOR TRIBAL COMPLIANCE REVIEW WAS UTILIZED UNSUCCESSFULLY FROM 2006-2010

The LFC Report suggests that the GCB not utilize cross-trained audit staff to perform the Tribal Gaming Compliance Inspections allowed by the Tribal-State Gaming Compacts. Instead, the LFC Report suggests that the GCB, or an independent Office of the State Gaming Representative, utilize employees who are dedicated to performing the monitoring and inspections authorized by the terms of the Tribal-State Gaming Compacts. The GCB has already utilized this proposed approach. By way of background, from 1998 through mid-2006, the GCB utilized the approach of cross-training Gaming Auditors to perform audits and inspections of all segments of the gaming industry. In mid-2006, the State Gaming Representative asked the GCB to allow two (2) Gaming Auditor positions to be dedicated to performing only the monitoring, inspection and compliance review work allowed by the Tribal-State Gaming Compacts. During the period from mid-2006 through mid-2010 the dedicated Tribal Gaming Auditor approach was utilized by the GCB. In addition, the State Gaming Representative was assigned an administrative support position. Given the difficulty of finding individuals with experience auditing gaming operations that are as

complex as the Tribal Gaming Operations the GCB was only able to fully staff both Tribal Gaming Auditor positions for one (1) month during this four (4) year period. As a result, the GCB's Audit and Compliance Division Gaming Auditors were occasionally asked to fill in and assist with the Tribal Compliance Inspection and monitoring activities.

In mid-2010, when the last dedicated Tribal Gaming Auditor resigned to seek employment with the City of Albuquerque, the GCB evaluated the allocation of resources and experienced staff to perform audit, monitoring, inspections and compliance reviews of all segments of the gaming industry. The GCB recognized that the dedicated staff approach did not work because positions were not regularly filled and recognized that the Audit and Compliance staff were already called on to assist that State Gaming Representative. As a result, the GCB elected to return to the approach that was successfully utilized for the eight (8) years prior to the failed experiment that began in mid-2006.

After returning to the original "cross-trained staff" approach, the GCB's Audit and Compliance Division discovered that the dedicated Tribal Gaming Auditors had not completed the annual compliance reviews for all Tribes in 2008. Accordingly, the GCB's Audit and Compliance Division was required to perform inspections covering a two (2) year period in order to bring Tribal Inspections current, as they were a year behind at that time. In addition, the dedicated Tribal Gaming Auditors had failed to review Statistical Net Win Reports and other Slot Accounting System data that was available to them and thus failed to discover that certain Tribes were not properly accounting for promotional point play and free play in calculating "net win" under the Compacts. As a result of utilizing experienced and "cross-trained staff" who were familiar with the Slot Accounting System data the GCB was able to conduct a review of similar data in possession of the Tribal Gaming Operations to fully inspect the Tribal Gaming Operations for compliance with the revenue share payment obligation arising under the Tribal-State Gaming Compacts. Within twelve (12) months of returning to the "cross trained" staff approach, all inspections were brought current and the Audit and Compliance Division staff had identified material underpayments of revenue share by the tribes.

F. CREATING AN OFFICE OF THE STATE GAMING REPRESENTATIVE DOES NOT INSURE THAT THE POSITION WILL BE FILLED CONTINUOUSLY, DOES NOT SAVE THE TAXPAYERS ANY MONEY AND CREATES AN ADDITIONAL AND UNNECESSARY COST TO STATE GOVERNMENT.

The LFC Report indicates that the State of New Mexico has struggled to appoint and retain a State Gaming Representative. It is important to remember that since December 1999 the duties and responsibilities of the position have been continuously performed. There has never been a period when the position has not been staffed and communication lines were open to the tribes.

The LFC Report suggests that individuals will stay in the SGR position for extended periods of time if the statute is changed to provide for an independent office of the State Gaming Representative, as opposed to the current framework where the SGR is appointed by the GCB. The LFC Report provides no facts to support this conclusion and it appears to be pure conjecture. Realistically, the Legislature should consider that with the exception of the current administration, the SGR position has been appointed by the Governor. As a result, the position was on several occasions occupied by individuals who held the position for short periods of time and required the GCB to appoint an interim SGR until the then sitting Governor made another political appointment.

The current approach is to conduct a diligent search for an individual who is well qualified and who will occupy the position for an extended period of time. The GCB is looking for individuals who have suitable backgrounds and experience to represent the State of New Mexico's interest while respecting the relationship between the State of New Mexico and the sovereign tribal governments. The GCB believes that it is prudent to use an experienced Interim SGR for purposes of knowledge, skill and understanding of the gaming industry until such time as a properly qualified candidate is identified for the position. In short, the GCB believes that it makes more sense to take the time to find "the right person" for the position as opposed to hiring "just any person" simply to say that the position is occupied by an appointee.

The LFC Report properly states that the Legislature has the ability to create an Office of the State Gaming Representative that is separate from the GCB. In order to create an independent agency as identified in the LFC Report, the New Mexico Legislature would be required to staff an agency with approximately 7-9 employees. The staff would likely consist of the State Gaming Representative, Gaming Auditors, administrative staff to perform administrative support, human resources, purchasing and budget work, a dedicated staff attorneys and dedicated information technology/information systems employees.

In addition to the salary and benefits for these employees the agency would need vehicles to travel to the Tribal Gaming Facilities, appropriate office space that provides for secure access to protect confidential information provided by the Tribes and a secure computer and software system similar in some respects to the Central Monitoring System. The agency would also need telecommunications systems, furniture, photocopiers, and computers, high end security systems, off-site and secure remote back up capabilities and arrangements with other state agencies to handle disaster response and recovery operations.

Everything that the SGR needs to function is currently in place at the GCB. The SGR has full administrative support and assistance, experienced legal counsel, a team of experienced auditors available for Compliance Inspections, the office space, computer systems, vehicles and security needed to perform the work. The State would not realize a cost savings by creating the independent Office of the State Gaming Representative because, as the LFC Report points out, the GCB currently needs all of the employees who assist the SGR in performing the duties of that position, to perform the other statutory and regulatory duties of the GCB.

The creation of an independent Office of the State Gaming Representative will not result in the realization of additional revenue for the State of New Mexico and will instead incur additional and unnecessary operating expenses. The GCB anticipates that the cost of creating and funding this agency that would perform a very limited scope of work would be between \$1,000,000 and \$1,500,000 per fiscal year.

G. THE GCB ENFORCEMENT AND INVESTIGATIONS DIVISION HAS FILLED ALL, BUT TWO, OF ITS ENFORCEMENT POSITIONS WITH CERTIFIED PEACE OFFICERS

The GCB, like the Livestock Board and local governments, historically relied on retired law enforcement personnel to staff its Enforcement Officer positions. Changes to the PERA statute restricting the ability of retirees to return to work for a PERA covered entity required the GCB, and other agencies, to revisit recruitment efforts to find qualified individuals to fill the Enforcement Officer positions. The GCB has worked through this challenge and currently employs certified peace officers in all but two Enforcement Officer positions (one Enforcement Officer position remains vacant and will not be filled until the sixth racetrack casino license is issued). Looking towards the future, the GCB is evaluating various recruiting methods to identify candidates who either have law enforcement certification or are eligible for a waiver. In that regard, the agency will look to find retired federal employees, military police officers, or certified law enforcement officers from other states. The GCB will also consider options such as employing individuals with forensic accounting and criminal analyst backgrounds and experience to supplement the Enforcement staff.

H. THE GCB'S ENFORCEMENT DIVISION HAS NEVER BEEN STAFFED IN A MANNER THAT CREATED ANY RISK OF POTENTIAL STATUTORY VIOLATIONS AT THE STATE'S GAMING LOCATIONS.

During the period FY09-FY11, the GCB Enforcement Division, like the Audit and Compliance Division was under budgetary constraints with respect to travel. It is during this time that inspections were reduced. The reduction in inspections had nothing to do with the inability to find certified peace officers for the agency. Accordingly, the suggestion that the integrity of the gaming industry was ever compromised is simply an incorrect statement based on conjecture and a lack of understanding of the work performed by the GCB Enforcement Division. The table on

page 4 of the LFC Report evidences that since the GCB received adequate funding to permit travel the number of inspections has increased year over year.

I. THE GOVERNOR'S OFFICE HAS ADDRESSED THE GCB'S CONCERNS ABOUT ACCESS TO DATA TO ALLOW FOR ACCESS TO ADDITIONAL DATA IN ORDER TO PERMIT IMPROVED COMPLIANCE INSPECTIONS IN THE NAVAJO COMPACT.

The LFC Report, suggests in a header without any underlying factual support thereafter, that the "Gaming compact provisions limit the GCB's ability to ensure tribal compliance creating significant risk in overseeing the state's interest in tribal gaming." The GCB is not able to respond to the conclusion contained in the header regarding "significant risks" because the LFC Report fails to identify the "significant risks" in the language that follows this very inflammatory suggestion.

Currently, the 2001 and 2007 Compacts contain broad language that is subject to dispute as to access to gaming records. During FY12, the GCB and the Tribal Gaming operators, through discussion and compromise, made strides in reaching agreement as to the scope of access to certain records. The Governor's Office, during the negotiation process for the 2013 Amended Compact, asked the GCB if changes in the Compact were necessary to assist them in performing the Compliance Review function. The Governor's Office and the Navajo Nation have included language that will assist the GCB in performing its Compliance Reviews and help to ensure that the State's interests are adequately protected.

The LFC Report also suggests that the GCB should, like Arizona, access gaming data electronically as opposed to obtaining required monthly reports that include the essential information to monitor the tribal gaming activities. The assumption of the LFC Report is that by reviewing electronic data the GCB will be permitted to do more consistent and timely verification of the gaming data. This assumption is based on the supposition that the electronic data is being provided to the GCB in a meaningful format and that the GCB is able to generate reports from that data. Until the GCB and the Tribes are able to work out the technical issues related to the transfer of electronic data, the Navajo Nation Compact has included meaningful changes that provide additional, detailed and specific monthly reports that will allow the GCB to conduct consistent and timely verification of gaming data.

J. SUGGESTIONS CONCERNING LEGISLATIVE OVERSIGHT FAIL TO TAKE INTO ACCOUNT THE FACT THAT THE TRIBES WHO ARE PARTIES TO THE COMPACTS WOULD HAVE TO AGREE TO SUCH CHANGES IN ANY AMENDMENT TO AN EXISTING COMPACT.

The LFC Report suggests a number of changes to the Tribal-State Gaming Compacts as a way to provide for greater "legislative oversight" of Tribal Gaming. However, the LFC Report fails to consider or even address the fact that the Tribes who are parties to the Compacts must agree to any changes in the Compact, including a change that would expand the disclosure of confidential and proprietary information related to the operation of their gaming establishments. The LFC Report provides some indication about how the Tribes feel about extending oversight to a Legislative agency or committee, in that the majority of Tribes contacted by the GCB, and we assume the LFC Analysts, would not grant a waiver to permit the LFC Analysts to review the Tribes' confidential information for purposes of analyzing data for the preparation of the LFC Report.

1. Wisconsin Compact Does Not Serve as the Best Model Given New Mexico's Form of Government.

The LFC Report points to the State of Wisconsin as an example to be considered by the State of New Mexico. As the LFC Report points out the "State Auditor" function in Wisconsin is seated in a Legislative Agency as opposed to being a separately elected State Office. Accordingly, if the Wisconsin Compact approach were to be used in New Mexico the goal of allowing the LFC staff to review source data from the Tribal Gaming operations would not be

met. Given New Mexico's form of government certain information would be made available to permit the State Auditor to audit the GCB's Compliance Review functions. Essentially, what happens in Wisconsin is that the State Auditor reviews the work of the agency that oversees gaming to insure that it is following its internal processes and obligations for gaming oversight.

The Tribal-State Gaming Compacts in Wisconsin contain very ambiguous terms with respect to the review of information in the possession of the State. The Wisconsin Compacts require the State to keep the information confidential with respect to the public but does not identify how it may be shared among State agencies. From a practical standpoint, and having reviewed documents from the State of Wisconsin, it appears that the agencies receiving data directly from the Tribes maintain that information in a confidential manner. The bodies that have "oversight or audit" responsibilities with respect to the agency that oversees Tribal gaming appear to review the work papers of the agency, as opposed to examining the actual confidential information provided by the Tribes.

The New Mexico Compacts contain more specific provisions that require any agency that receives information from the Tribes to maintain that information in a confidential manner. This provision is similar in many respects to Gaming Compacts in Arizona, Connecticut, Florida and New York.

2. The LFC Report Suggests that Pueblo of Pojoaque, Mescalero Apache Tribe, Pueblo of Acoma and Jicarilla Apache Tribe Amended Compacts Should Provide for a Higher Level of Legislative Oversight Than Tribes Operating Under the 2007 Amended Compacts or the 2013 Amended Compact that the Joint Compact Committee Approved for the Navajo Nation.

The LFC Report suggests that if the parties who are still negotiating an Amendment to their respective 2001 Tribal-State Gaming Compact do not provide for greater legislative oversight and access to information regarding operation of the Tribal Gaming and that the Legislature should propose amendments that would provide for greater legislative oversight. The problem with this suggestion is that it ignores the fact that legislative oversight was not anticipated here, just as it was not anticipated in any agency where confidentiality is an essential component of the relationship.

3. Recent Events Provide an Indication that Tribes Have Taken the Position that Free Play has Monetary Value.

In interim committee hearings in the fall and winter of 2012, and in discussions with various Gaming Tribes, individuals have stated that free play is "phantom money" and has no real value and thus the Gaming Tribes should not be required to pay revenue share based on the value of the free play. Recently, more than one Tribe has, through the United States' Attorney's Office, prosecuted casino employees and family members for "theft" of free play and promotional points. The nature of the federal charges demonstrates that the Gaming Tribes themselves recognize a monetary value on the free play or promotional points taken from the gaming establishment. If the free play and point play truly have no value or are simply "phantom money" there would be insufficient evidence to charge the employees with a crime. It should also be pointed out that the criminal investigations leading to the federal charges were conducted by tribal police departments and the evidence of the crimes came from the Tribal Gaming operators.

4. The GCB's Position Concerning Free Play is Based on the Position Taken by the Attorney General's Office of Two States Who Successfully Pursued the Underpayment of Revenue Share By Gaming Tribes.

The LFC Report indicates that the LFC Analyst was unable to independently verify if the GCB's position on free play or if the amount of revenue share underpayment was accurate. Any suggestion that the LFC Analysts' efforts to verify the numbers were thwarted by the GCB is undermined by the LFC Analysts disclosure of the fact that the

Tribes would not allow the LFC staff to see the confidential and proprietary information related to the gaming operations.

The GCB has repeatedly stated that it is not taking a novel or untried approach in its pursuit of the underpayment of revenue share to the State. Rather, the GCB has conferred with attorneys who have pursued the underpayment of revenue share in other states to determine if its position is consistent given similar facts and Compact provisions. The GCB was able to evaluate the legal and accounting positions taken by the states and the tribes in those cases. Every argument and position taken by the New Mexico Tribes whom the GCB contends have underpaid revenue share has been made by the gaming tribes involved in the litigation brought in those states. Accordingly, the GCB has been aware of the “generally accepting accounting principle” , “phantom money,” and “wager vs. non-wager” arguments raised by the Tribes to date. These arguments have not been successful in the jurisdictions where the issue has been litigated. To the contrary, after raising the arguments in other jurisdictions the tribes in those states settled the disputes. In one case, the gaming tribe allowed a state to take the full \$25 million dollars that had been placed in escrow at the outset of the litigation. In exchange, the state agreed to a new approach for revenue share calculation on free play going forward.

K. THE NAVAJO COMPACT WAS APPROVED BY THE JOINT COMPACT COMMITTEE AND WILL BE ONE OF THE FIRST ITEMS OF BUSINESS FOR THE NEW MEXICO LEGISLATURE IN 2014.

The LFC Report takes issue with a number of provisions in the 2013 Amended Tribal-State Gaming Compact between the State of New Mexico and the Navajo Nation. At this point, the Joint Compact Committee has already recommended approval of the proposed Navajo Compact pursuant to NMSA Section 11-13A-4(B). Because the Joint Resolution does not appear to have been presented to the legislature during the 2013 Regular Session, Section 11-13A-4(H) is operative and will require the Joint Resolution to be presented to the legislature and acted upon no later than the second day of the next regular or special legislative session.

1. Legislative and Compact Restrictions on the Number of Gaming Machines, Gaming Tax Rate, Required Payment to Racing Purse Fund, Absence of Table Games and Other Issues Create Real Problem for Sunray Park Racetrack and Casino (“Sunray Park”).

While the presence of Tribal competition has created problems for Sunray Park, the LFC cannot ignore the fact that the playing field between the entities is not equal. The LFC Report suggests that the limitation on the number of machines and hours of operation that is included in the 2013 Amended Tribal-State Gaming Compact with the Navajo Nation is something new. That is simply not an accurate representation. The limitations that are included in the 2013 Amended Tribal-State Gaming Compact have existed since the State of New Mexico entered into the 2007 Amended Tribal-State Gaming Compact and are in the Gaming Control Act. Given the fact that the State included these limitations in the Gaming Control Act and in the 2007 Compact, Sunray Park was already operating under these restrictions. The fact that the Navajo Nation may, after 2014 or 2015, be operating under a Compact that has terms that are similar to the 2007 Compact is of no significance and has no impact on Sunray Park.

With respect to Sunray Park it would be a mistake to say that the mere presence of Navajo Casinos is the reason for their declining revenue. A more thorough analysis would ask the question if Sunray Park is in a position to compete with other gaming enterprises in geographic proximity. If questioned, as has been done by the GCB at a number of meetings relating to preparation of the GCB's Response to SM 52 last year, Sunray Park would tell the LFC Staff that Sunray Park is not in a financial position to compete because the Navajo Nation pays only 8% of its “net win” in revenue sharing while Sunray Park is required to pay 26% of its “net win” in Gaming Tax and another 20% of its “net win” to racing purses. On top of that Sunray Park pays an excise tax of 10% on each gaming machine it purchases. Sunray Park would also say that the restriction on blackjack, craps and poker tables also impairs its ability to compete. Finally, the restriction on the number of gaming machines and hours of operation, as opposed to no such restriction on the Navajo Nation, has created a playing field that makes it difficult for Sunray Park to realize enough net income to allow it to reinvest in its casino operations.

The answers to Sunray Park's revenue problem are: (1) the oil and gas industry returns to San Juan County in a significant way soon; (2) to relocate to an area where Tribal competition is not an issue; or, (3) to obtain a change in the statutory framework to permit it to truly compete with the Navajo Nation at its current location. Some will argue that the racetrack casinos did not complain about the imposition of a 25% gaming tax rate in 1997. While that statement may be true, it must also be considered in its proper context. In 1997, the Tribal-State Gaming Compacts and the statutory Tribal State Gaming Compact (NMSA 1978, Section 11-13A-2) required the Tribes to pay a 16% revenue share rate. When the State agreed to 50% reduction in the revenue share rate for the Tribal Gaming Operations in 2001, the Legislature did not adopt a statutory change reducing the gaming tax rate for the racetrack casinos.

2. The LFC Report Recommends that the State Tell Another Sovereign Governmental Entity Where it May Locate a Business on its Tribal Lands.

The LFC Report suggests that the State of New Mexico should, through the terms of a Compact, serve as a regulatory body that controls what competition is permitted between Tribal Casinos. In essence, the State would serve a role that is similar to the Public Regulation Commissions role in approving a license to operate an ambulance service. The PRC's role in that context is to insure that enough service is available to the public and yet insures that the ambulance companies do not have competition such that it impairs the profitability of the operators. In other words, there is no need for three ambulance companies to exist if two are currently providing satisfactory services and are making adequate profits.

The LFC Report raises the issue of whether the State of New Mexico should prohibit the Navajo Nation from competing with the Pueblo of Laguna and the Pueblo of Acoma on their respective sovereign lands. Certainly, before the Navajo Nation would consider building a casino that would compete with the Pueblo of Laguna or the Pueblo of Acoma it would conduct an analysis to determine whether the market would support another casino in that area. It is difficult to fathom that the State of New Mexico would attempt to tell the State of Utah and the State of Colorado that they could not locate competing business ventures within a certain distance of each other on their respective state lands.

Before suggesting a limitation on a Tribe's ability to place a casino in any particular area on its Tribal Lands, it is recommended that thorough legal research be conducted to evaluate whether this type of infringement on Tribal sovereignty is allowed. While the Department of the Interior has previously approved Tribal-State Gaming Compacts that contain agreed restrictions on the number of casinos that may be operated, it is highly unlikely that the Department of the Interior would permit a State to tell a Tribe **where** it may, or may not, place a casino on its sovereign lands.

3. The LFC Report Fails to Consider Factors Other Than Market Saturation In Analyzing Gaming Revenue Growth from FY 08- FY 12.

On page 7 of the LFC Report, the LFC Analyst correctly indicates that overall gaming revenue has grown only 4% between FY-08-FY12. However, the LFC Report is too quick to conclude that the only reason for what they consider to be a flat growth rate is market saturation. A review of the overall economy could provide an equally plausible explanation for relatively flat growth rates. The Gross Domestic Product for the period 2008-2010 demonstrates a very similar growth rate. However, for the period 2010-2012, Tribal Gaming revenue growth continued while the Gross Domestic Product decreased. It is also worth noting that the AZ Department of Gaming reports that the last two (2) years it has experienced a similar growth rate in what it knows is not an oversaturated gaming market.

The GCB does agree that the data suggests that gaming revenue is passed from casino to casino based on the strength of its marketing operations and perhaps the entry of a new casino into the market. The data suggests that free play promotions do not generate new business but rather only attract existing players from one casino to the next. As a result, the State of New Mexico is not seeing an increase in gaming revenue. The marketing efforts of the Tribal Casinos and the free play and other promotions that the casinos are offering do not seem to be attracting new players to the jurisdiction from other states or countries, in any statistically demonstrable numbers.

4. If the Legislature Wishes to Address Market Saturation it Should Consider Repealing the Automatic Sign-On Provision in 11-13A-4(J).

The Compact Negotiation Act, at Section 11-13A-4(J) contains a provision that allows any Tribe that had lands in trust prior to October 1987 to sign on to an existing Tribal-State Gaming Compact. This provision prevents the State of New Mexico from considering whether a Tribe will be locating a gaming facility in an area where the gaming market may already be saturated. If that provision of the statute were eliminated the State of New Mexico would be in a position to negotiate an arms-length Tribal-State Gaming Compact that accounted for the economic realities of the geographical area in which a proposed casino would be located.

5. The Terms of the Amended Navajo Nation Compact Regarding Free Play Will Increase the Revenue Share Received by the State of New Mexico.

The LFC Report indicates that the inclusion of the method for determining how much revenue the State will receive from free play is unsubstantial. It is difficult to respond to this conclusion because the Report fails to identify the line of demarcation for determining substantiality. However, there is no dispute that as a result of the increased revenue share rate and the agreed inclusion of a percentage of free play, the State of New Mexico will receive greater revenue from the Navajo Nation's gaming establishments. The LFC Report assumes, apparently as a worst case scenario, that the Nation will have an 80%-20% ratio of Class III to Class II machines in each of its gaming facilities. (This does not seem likely given the fact that they have NO Class II Machines at either the Northern Edge or Fire Rock facilities.) However, assuming this worst case scenario, the Nation would pay an additional 8% in revenue share to the State. If the current ratio of 100%-0%, Class III to Class II machines, exists the Nation will pay an additional 36% in revenue share to the State. Given current interest rates and rate of return on investment it is difficult to comprehend how an 8%-36% increase in revenue is deemed unsubstantial.

L. NATIONALLY, CLASS II GAMING IS GIVING WAY TO CLASS III GAMING.

Literature discussing Class II vs. Class III gaming suggests that Class II gaming is "starter gaming" in that it is present in those jurisdictions where a state has not yet agreed to permit Class III gaming. In the event that a state refuses to allow Class III gaming, a tribe may still build a gaming facility on its pre-October 1987 tribal lands and utilize Class II gaming machines. (The difference between a Class II and Class III gaming machine is the method by which they operate. A Class II machine determines the winner through a bingo based method and requires that the machines be pooled and the players compete against each other for the prize. A Class III machine determines a winner through a random number generator and a single player is all that is needed to play the game.) As is demonstrated in Oklahoma and Florida, Tribes that are permitted to conduct Class III gaming will convert the base of their gaming operation from Class II machines to Class III machines and agree to pay revenue share payments simply because Class III gaming is economically advantageous for the gaming tribe. While a tribe operating a Class II facility could avoid paying any revenue share to a state, the simple economics demonstrate that Class III gaming generates more revenue and is a more preferable and profitable manner in which to operate a gaming facility.

While continued evolution in the development and presentation of Class II gaming machines could result in the introduction of more machines at tribal casinos, there are a number of factors that come into play when assessing the overall lack of success of Class II gaming. Among the items are: (1) patrons play games that they are familiar with-if they grew up with class II titles, they will continue play those games; NM customers are not familiar with current class II titles;(2) the industry has not funded the conversion of common titles, such as Wheel of Fortune, to Class II; and (3) finally and most importantly, most manufacturers of Class II do not sell their product-they charge a participation fee i.e. a lease; therefore it is cheaper for a casino to pay the state 8% on a class III game than to pay a manufacturer, 10 or 20% etc. on a Class II machine.

In New Mexico there are 209 Class II gaming machines. The majority of those machines 120 or 57.4 % of all Class II machines in the State of New Mexico are located in a single facility in Hogback, NM. The remaining 89 or 42.6% of machines are utilized to supplement gaming opportunities in Tribal Casinos. Based on GCB inspections

the remaining 89 machines (an average of less than 4 machines per casino) have been installed in the bar areas of Tribal Gaming establishments. The reason that the Class II machines are located in the bar area is because the Tribal-State Gaming Compacts do not permit Class III gaming in the bar area of a casino. It is also worth noting, that GCB inspections discovered that one gaming tribe installed 80 Class II machines on their gaming floor in 2011. Within 18 months of installation all of the Class II machines were removed from the facility.

Based on data presented on page 8 of the LFC Report, Class II gaming machines represented only 1.3% of all tribal gaming machines in both FY11 and FY12. The growth rate for Class III machines for the same period was 5.2%. The net increase in Class II gaming machines from FY 11 to FY 12 was 9 machines. The net increase in Class III gaming machines during the same period was 774. Based on the data that the GCB has reviewed, there has not been any material increase in the number of Class II gaming machines at Tribal Gaming facilities between FY08 and FY12. Since the Navajo Nation opened their Class II facility in Hogback in 2009, 89 Class II gaming machines have been added at all of the other Tribal Gaming facilities. In the four years since the Hogback facility opened the other 13 Gaming Tribes have added an average of 1.7 Class II machines per year per tribe. In FY11 there were 209 Class II Gaming Machines and 15,913 Class III in New Mexico Tribal Casinos.

During a meeting with the Arizona Department of Gaming on May 1, 2013, the GCB asked if the gaming tribes in Arizona were expanding the presence of Class II machines. The Arizona Department of Gaming advised that, in fact, the number of Class II machines in the jurisdiction decreased in the last year. The total number of Class II Gaming Machines in Arizona is 60 and the total number of Class III Gaming Machines is 14, 325. Based on available information, it appears as though the only state to experience an increase in Class II machines in the last year is the State of Oklahoma. However, it should be noted that Oklahoma has traditionally utilized Class II gaming to a greater extent than Class III and for an extended period of time only had Class II gaming in that state.

M. THE LFC REPORT INCORRECTLY CONCLUDES THAT THE GAMING CONTROL ACT PROVIDES THE STATUTORY BASIS FOR CLOSING ROGUE RACE TRACKS.

At Page 20 of the LFC Report the LFC staff states: "The NMRC could leverage potential partnerships with other agencies such as the GCB in addressing illegal racetracks. The New Mexico Gaming Control Act states possession of a gaming device without a license or controlling a place where such devices are located is a violation."

The GCB assumes that the LFC Staff is suggesting that a horse is a gaming device. The suggestion that a horse is a gaming device ignores the statutory definition of "gaming device" found at NMSA 1978, Section 60-2E-3. A gaming device means associated equipment or a gaming machine and includes a system for processing information that can alter the normal criteria of random selection that affects the operation of a game or determines the outcome of a game. Given the fact that in 2009, the Chaves County District Attorney's Office was unsuccessful in its efforts to prosecute a violation of the New Mexico Horse Racing Act because they could not prove that the horse was a "racehorse" as required by law, thus it would be incredibly difficult for the GCB to provide evidence that a horse is a "gaming device."

As the GCB has previously advised, it will continue to work cooperatively with federal, state and local law enforcement agencies in their efforts to close the rogue tracks. The GCB is adamantly opposed to the animal cruelty and other illicit activities that are associated with the operation of these tracks.

N. RECOMMENDATIONS:

- 1. Based on the Gaming Tribes Refusal to Grant the LFC Staff Access to Confidential Gaming Records, It is Unlikely the Gaming Tribes will Agree to Compact Changes that Require Disclosure to a Legislative Committee or the Staff of a Legislative Committee.**

The LFC Staff recommends that the State request that the Gaming Tribes renegotiate the terms of existing Tribal-State Gaming Compacts to create a process formal cyclical review of tribal gaming and compact compliance by both the state and the tribes. Simply put, the recommendation is to ask a sovereign nation to open up an existing

Compact to obtain that sovereign nation's consent to subject its gaming operations to oversight by the legislative body of another sovereign government. The recommendation appears to ignore the fact that, when requested, the Gaming Tribes refused to grant a waiver to allow the LFC Staff to review source documentation related to gaming operations. While the Compact Negotiation Act does provide a mechanism to permit the Legislature to ask a Tribe to enter into negotiations to amend an existing Compact, based on the GCB's experience in administering the Compacts it appears unlikely that a Gaming Tribe would agree to expand access to the confidential gaming documents.

Presently, the only real opportunity to implement the recommended changes exists with the ongoing negotiations with four (4) of the fourteen (14) Gaming Tribes. However, it must be noted that each of the remaining Gaming Tribes would have to agree to the change. It is unlikely that the four (4) remaining Gaming Tribes would agree to allow for legislative oversight when their competitors do not face similar regulation.

2. The LFC Report Suggests that the GCB is Understaffed and Underfunded and Yet Makes No Recommendation For Additional Funding or Additional Staff.

The GCB, like many other agencies has been asked to do more with less given budgetary constraints. Based on the LFC Report it appears that LFC Analysts reviewing the GCB believe that the agency needs additional staff to perform audit, compliance and enforcement functions. The GCB will be requesting in coming fiscal years that the LFC Staff recommend full funding for the necessary positions and the associated costs of travel, office space, etc. Currently, the GCB is limited in its ability to house additional personnel as a result of the GCB being required to house the New Mexico Racing Commission in its leased space. It is the shared hope of both the GCB and the Racing Commission that the NM Legislature will approve a budgetary increase for the Racing Commission so that they may find their own office space which will free up existing space for use by the GCB.

3. Altering Racing and Gaming License Process.

The GCB takes no position on this recommendation. As with any statutorily imposed duty, the GCB will comply with the statutes that govern its operation.

4. Tracking Class II Gaming Machines.

Since the Audit and Compliance Division resumed the compliance inspections for the Gaming Tribes, the SGR and the Gaming Auditors have been maintaining records of Class II Gaming Machines. The GCB agrees that this information should be tracked into the future. The GCB does not agree with the recommendation that the count take place at a set time each year. If the GCB were to have a set date for each machine count, there are certain risks associated with movement of gaming machines that could result in an inaccurate count of gaming machines in use. The GCB recommends that it retain the ability to perform machine counts as part of its annual inspection and more importantly as part of random visits to the gaming facilities, as permitted in the Compacts.

5. Audit and Compliance Division Approach to Audits and Inspections.

As noted above, the GCB's Audit and Compliance Division already uses a risk based approach to performing its audit programs. Accordingly, no change is needed in the Divisions current operating practice. However, the GCB will look at its regulations to determine whether changes are needed with respect to the frequency and scheduling of audits.

With respect to the recommendation that the audit and compliance division segregate duties for tribal inspections vis-à-vis the audits of its licensees, the GCB submits that this approach was utilized unsuccessfully for a four (4) year period. The GCB does not believe that it makes sense to return to an approach that experience shows is a method that does not effectively protect the interests of the State of New Mexico.

Respectfully submitted,

Jeffrey S. Landers

cc: Maria Griego via email – maria.griego@state.nm.us
Charles Sallee via email – Charles.Sallee@state.nm.us

APPENDIX A: EVALUATION OBJECTIVES, SCOPE AND METHODOLOGY

Evaluation Objectives.

- Review the regulatory effectiveness of both the GCB and the NMRC in carrying out their statutorily-mandated oversight functions.
- Assess the GCB's and NMRC's ability to enforce regulations and minimize infractions to ensure the integrity of the racing and gaming industries.
- Analyze how the GCB and NMRC manage their operations, work together in joint oversight functions, and stay updated on emerging issues in racing and gaming.
- Examine agency compliance with tax, license, and revenue-sharing requirements.

Scope and Methodology.

- Reviewed state statutes, departmental and division policies, procedures, and internal management documents.
- Conducted structured interviews with Gaming Control Board and New Mexico Racing Commission staff, and key stakeholder groups.
- Reviewed financial, performance, and quality data from the agencies.
- Reviewed published literature on other state practices, press releases, and media reports relevant to the evaluation.

Evaluation Team.

Maria D. Griego, Lead Program Evaluator

Michael Weinberg, Program Evaluator

Authority for Evaluation. The LFC is authorized under the provisions of Section 2-5-3 NMSA 1978 to examine laws governing the finances and operations of departments, agencies, and institutions of New Mexico and all of its political subdivisions; the effects of laws on the proper functioning of these governmental units; and the policies and costs. The LFC is also authorized to make recommendations for change to the Legislature. In furtherance of its statutory responsibility, the LFC may conduct inquiries into specific transactions affecting the operating policies and cost of governmental units and their compliance with state laws.

Exit Conference. The contents of this report were discussed with the Gaming Control Board and New Mexico Racing Commission during the exit conference on April 2, 2013. A draft report for informal feedback was provided at that time. A report draft was provided to both agencies on April 17, 2013 for formal written response.

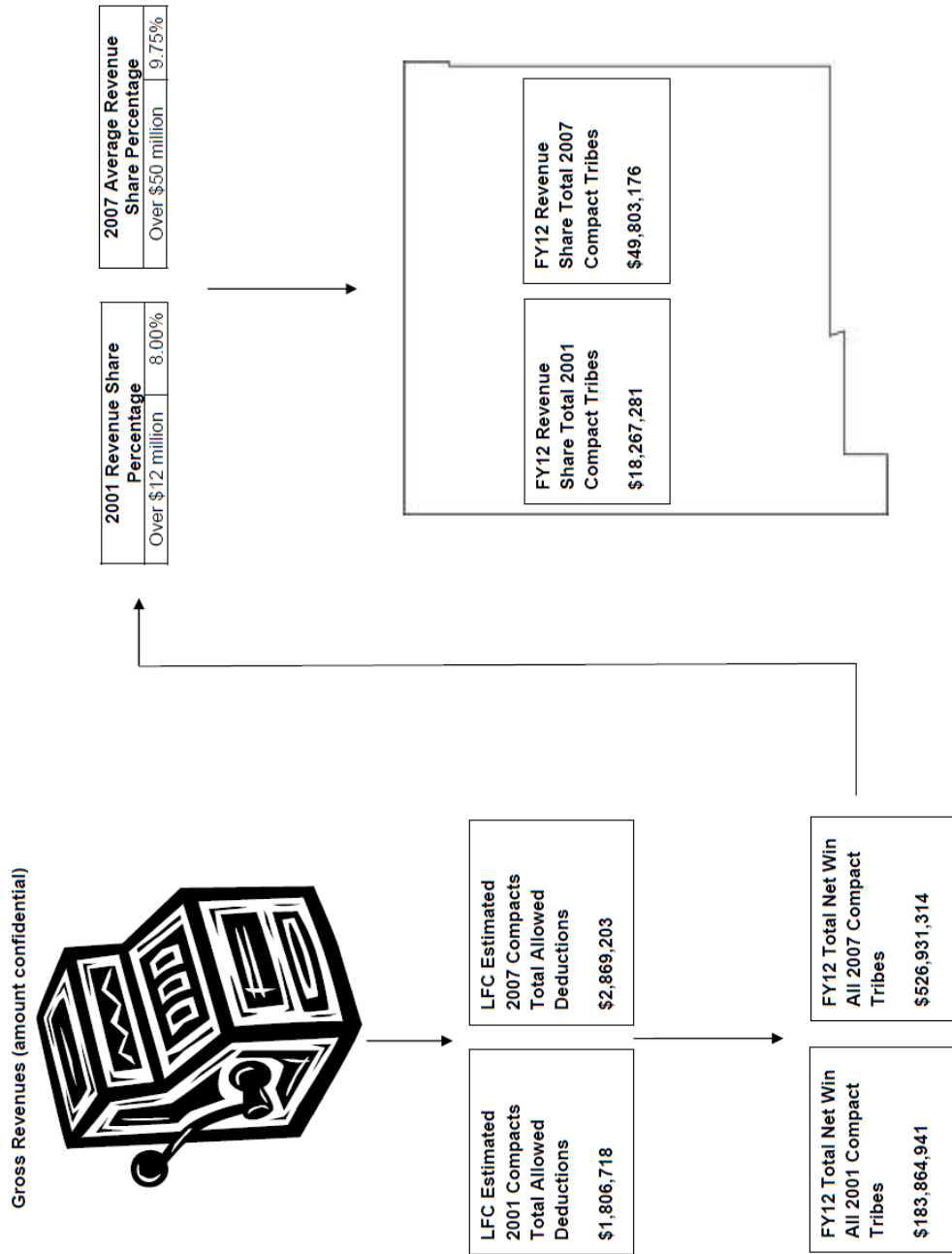
Report Distribution. This report is intended for the information of the Office of the Governor, the New Mexico Racing Commission, the Gaming Control Board, the Office of the State Auditor, and the Legislative Finance Committee. This restriction is not intended to limit distribution of this report, which is a matter of public record.



Charles Sallee

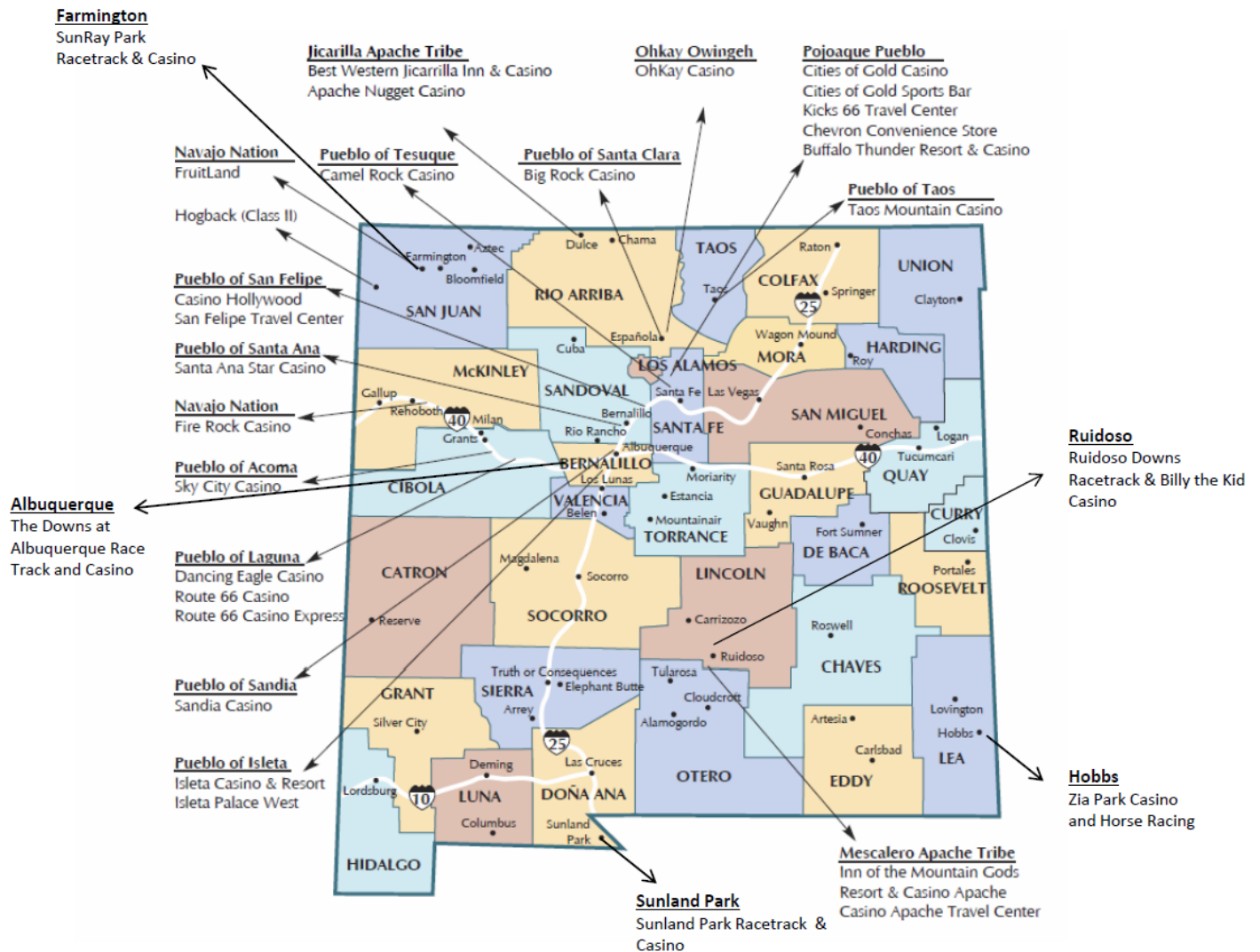
Deputy Director for Program Evaluation

APPENDIX B: TRIBAL GAMING REVENUE SHARE CALCULATION FY12



Source: GCB/Tribal Gaming Compacts

APPENDIX C: NEW MEXICO TRIBAL AND RACETRACK CASINO LOCATIONS



APPENDIX D: EQUINE TESTING FREQUENCY BY JURISDICTION

Jurisdiction	Average Number of Tests per Race
Arkansas	4.0
Arizona	4.0
California	4.0
Colorado	2.5
Delaware Harness	4.0
Delaware Thoroughbred	4.0
Florida	4.0
Iowa	3.0
Idaho	2.0
Illinois	3.5
Kentucky	3.0
Louisiana	2.5
Massachusetts	3.0
Maryland	4.0
Michigan	4.5
Minnesota	5.5
Mobile County	2.0
Nebraska	2.0
New Jersey	3.0
New York	6.5
Nevada	2.0
Ohio	3.5
Oklahoma	4.5
Oregon	3.5
Pennsylvania	3.0
South Dakota	2.5
Texas	4.5
Virginia	3.0
Washington	4.0
West Virginia	4.0
Wyoming	2.0
Average	3.5
New Mexico	2.0

Source: ARCI