



# *Bureau of Gambling Control and California Gambling Control Commission*

Their Licensing Processes Are Inefficient and  
Foster Unequal Treatment of Applicants

*May 2019*

**REPORT 2018-132**





**CALIFORNIA STATE AUDITOR**

621 Capitol Mall, Suite 1200 | Sacramento | CA | 95814



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May 16, 2019  
**2018-132**

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As directed by the Joint Legislative Audit Committee, the California State Auditor conducted an audit of the California Department of Justice's Bureau of Gambling Control (bureau) and the California Gambling Control Commission (commission). The audit focused on each entity's regulatory duties that the Gambling Control Fund supports, which include the licensing of individuals who own or work in card rooms. This report concludes that the bureau's and commission's incomplete or inconsistent procedures have contributed to delays and backlogs for gaming license applicants and have resulted in unequal treatment for applicants and licensees.

Despite receiving significant additional resources from the Legislature, the bureau has failed to clear its backlog of pending license applications. In fact, its productivity has declined over the past few fiscal years, and our review identified inefficiencies in its processes and concerns about how staff report spending their time. The bureau and the commission have each engaged in inefficient practices that delay licensing denials, and it may require legislative intervention to address the commission's delays.

To varying degrees, both the bureau and the commission have charged fees that result in unequal treatment of license applicants. Although our review did not identify evidence of discrimination by either entity on the basis of individuals' ethnicities or related characteristics, we determined that the bureau's incomplete or inconsistent procedures resulted in unequal treatment related to the level of scrutiny applicants received. Furthermore, neither the bureau nor the commission has addressed the fact that the fees they charge do not align with their costs for providing oversight. Such misalignment has contributed to an excessive surplus in the Gambling Control Fund and may call into question the legality of some fees.

Respectfully submitted,

A handwritten signature in black ink that reads "Elaine M. Howle". The signature is written in a cursive, flowing style.

ELAINE M. HOWLE, CPA  
California State Auditor

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## SUMMARY

The Gambling Control Act (Gambling Act) and state regulations give the California Department of Justice's Bureau of Gambling Control (bureau) and the California Gambling Control Commission (commission) distinct responsibilities for a range of licensing and enforcement activities related to gaming businesses—primarily card rooms—in California. Generally speaking, the bureau is responsible for performing background investigations of applicants seeking licenses that will enable them to own or work in these gaming businesses and for enforcing gaming laws and regulations. The commission, on the other hand, is an independent body that makes licensing decisions in consideration of the bureau's recommendations and, when applicable, takes or upholds disciplinary actions against licensees, such as license revocation. To meet their responsibilities, the bureau and the commission receive funding from the Gambling Control Fund (Gambling Fund). Given the broad discretion that the bureau has in reviewing license applications and that the commission has in reaching determinations about applicants' suitability for licenses, we reviewed these entities' processes to determine the extent to which they have treated applicants consistently. Our report concludes the following:

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### **The Bureau's and Commission's Inefficiencies Have Driven Delays and Compounded Backlogs in the Licensing Process**

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Our review of 23 gaming license applications found that the bureau regularly exceeded the statutory time frame of 180 days for completing its review of applications. Although the bureau cited a lack of available resources as a factor in the delays, we question its efficiency given that temporary funding it received from the Legislature for 32 additional positions has more than doubled its licensing staff since fiscal year 2015–16. The temporary funding is set to expire in June 2019, yet the bureau has not sufficiently demonstrated what an appropriate permanent staffing level would be. In fact, despite its increased staffing, the bureau still has a backlog of almost 1,000 applications, likely in part because its productivity has diminished since it hired its new staff. In contrast, the commission complied with its separate regulatory time frame of 120 days when it approved applications at its regular licensing meetings. However, its practice of holding evidentiary hearings to deny license applications—an approach the commission explained it implemented to conform to the Gambling Act—contributed to significant delays and use of extra staff resources in its handling of such applications.

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**Page 31****The Bureau and Commission Have Charged Fees That Do Not Align With Regulatory Costs, Resulting in an Excessive Surplus and Fairness Concerns**

The bureau and the commission have established regulatory fees that do not align with the actual costs that they incur when performing oversight activities. These fees—which applicants and gaming business owners pay—raise questions about the legality and fairness of the current fee structure. In part because some of the fees are higher than necessary, the balance in the Gambling Fund has doubled over the past five years, and it is projected to increase to \$97 million by June 2020. If the balance reaches this amount, it will represent a surplus of more than five times the combined annual operating expenditures of the bureau and commission. This excessive surplus has enabled the bureau to engage in inconsistent billing and time-management practices. Specifically, the bureau’s billing processes have resulted in many applicants’ not paying for the actual costs of their background investigations. Further, bureau licensing staff have reported spending the majority of their time on activities that may not be productive or even directly related to license applications.

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**Page 43****The Bureau’s and Commission’s Inconsistent Regulations and Practices Have Resulted in the Unequal Treatment of Applicants**

The bureau and commission have not ensured that their regulations and practices treat all applicants consistently and fairly. Specifically, the commission’s regulations create unjustified differences in terms of the time frames in which individuals must submit applications, the circumstances under which they may hold temporary licenses, and the notifications they receive about their application status, among other issues. The bureau’s procedures for conducting background investigations further contribute to the inconsistent treatment of applicants because the procedures require different levels of review for different license types without justification. Finally, the commission lacks procedures to ensure that it allows applicants to withdraw from the hearing process, and as a result, it publishes decisions that include unnecessary negative information about some applicants. Because the bureau and commission have considerable discretion in reviewing license applications and in making licensing decisions, respectively, any inconsistencies that affect applicants’ experiences during the licensing process may exacerbate perceptions of bias or lead to questions of fairness.



## Summary of Recommendations

### *Legislature*

To ensure the prudent use of Gambling Fund resources, the Legislature should not approve any requests to make permanent the funding for the bureau's 32 additional positions. Instead, the Legislature should extend the funding for an additional two years to give the bureau time to clear its backlog of applications and to implement our recommendations to improve its application processing.

To prevent delays and the unnecessary use of resources in the processing of licensing applications, the Legislature should amend the Gambling Act to allow the commission to take action at its regular licensing meetings rather than requiring it to hold evidentiary hearings.

### *Bureau*

To ensure that it approaches its backlog strategically and that it is accountable for its use of resources, the bureau should establish a formal plan by November 2019 for completing its review of the remaining pending applications.

To ensure that it fairly charges applicants for the costs of their background investigations, the bureau should establish and implement policies by July 2019 that require staff to properly and equitably report and bill the time they spend conducting such investigations.

### *Commission*

To prevent delays and the unnecessary use of resources, the commission should, following the Legislature's amendment to the law that we recommend, revise its relevant regulations to specify that it is not required to hold evidentiary hearings unless applicants request that it do so.

***Bureau and Commission***

To better align the revenue in the Gambling Fund with the costs of the activities that the fund supports, the bureau and the commission should conduct cost analyses of those activities by July 2020, and they should adjust their fees to reflect the actual costs of the oversight activities they perform.

**Agency Comments**

The bureau agreed with most of our recommendations and identified actions that it is taking or planning to take to implement them. However, it disagreed with our recommendation that the Legislature extend temporary funding for additional bureau staff for two years instead of making that funding permanent. The commission generally agreed with our recommendations and identified actions it is taking or planning to take to implement them. However, it disagreed with our implementation time frames for two recommendations.

# INTRODUCTION

## Background

The Bureau of Gambling Control (bureau) is part of the California Department of Justice (Justice), whereas the California Gambling Control Commission (commission) is an independent entity. In addition to regulating tribal-operated casinos, the bureau and the commission each have responsibilities for licensing and enforcement activities related to certain gaming businesses in California. These gaming businesses consist predominantly of card rooms that offer poker-style and other table games to the public. Card rooms differ from tribal casinos in how they generate revenue and in the specific types of gaming they can offer.

The Gambling Control Act (Gambling Act) requires people who own or work in card rooms to be 21 years of age and to hold commission-issued gaming licenses, which they must renew periodically.<sup>1</sup> Further, the Gambling Act prevents the licensing of any additional card rooms beyond those that the commission has already licensed, therefore limiting the number of card rooms that can operate in the State. As of March 2019, the commission reported 87 licensed card rooms in California. The size of these card rooms varies from businesses with just a few gaming tables to large establishments with more than 200.

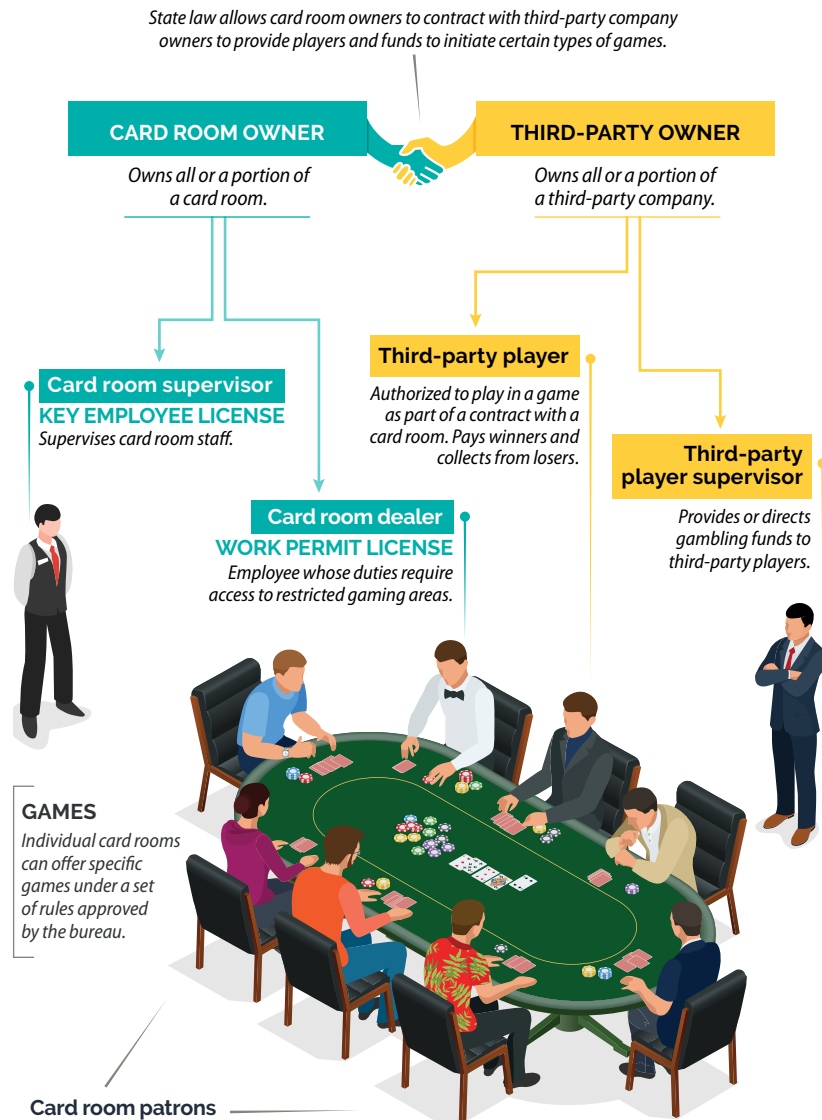
This audit focuses on the manner in which the bureau and commission individually carry out regulatory roles supported by the Gambling Control Fund (Gambling Fund). The Gambling Fund receives revenue from the licensing and regulatory fees that those who own, operate, and work in card rooms and related businesses pay. Since fiscal year 2010–11, the bureau's and commission's expenditures have comprised an average of 98 percent of all Gambling Fund expenditures. Although the bureau and commission also perform regulatory activities for tribal casinos, these activities are distinct from those for card rooms and are financed by a separate fund; therefore, this audit does not focus on the bureau's and commission's regulation of tribal casinos.

## Types of Gaming Licenses

The bureau and commission perform activities related to processing, approving, and otherwise regulating gaming licenses for card rooms and related businesses, as well as their owners and employees. With the exception of the card room patron, each of the gaming roles that Figure 1 depicts requires a distinct type of license. Many licenses go to individuals who work in the gaming industry, such as card dealers and floor supervisors. Even employees working in nongaming roles, such as food service, must hold licenses. In general, the licenses subject to the most in-depth review are those held by business owners—individuals who partially or fully own card rooms or who provide players for certain types of games, as we discuss below. Although state law does not allow the licensure of new card rooms, individuals may buy existing card rooms, which requires these individuals to apply for licenses. Finally, as Figure 1 shows, card rooms must also obtain approval for the rules of every game they offer to their patrons.

<sup>1</sup> The commission issues some but not all gaming licenses known as work permits; local jurisdictions also issue some work permits. This report focuses on work permits that the commission issues.

**Figure 1**  
License Types Correspond to Individual Roles in Card Rooms



Source: Business and Professions Code; California Code of Regulations, title 4, section 12002 et seq.; California Code of Regulations, title 11, section 2000 et seq.; and bureau documentation.

Games that card rooms offer include poker-style games, in which players wager against one another. They may also offer variations on games such as blackjack or baccarat—known as California games—in which players wager against a single individual. State law allows card room owners to generate revenue based on the volume of game play taking place in their establishments, but it bars them from benefiting from the outcome of any games or from players' winning or losing money. Therefore, card rooms earn revenue by charging players to participate in games and by selling food and drinks.

The fact that state law prohibits card rooms from benefitting from the outcomes of games means they cannot act as the house or bank.<sup>2</sup> Therefore, in order to offer certain California games, the card rooms depend on patrons' acting in a role known as the player-dealer, paying players who win and collecting from those who lose. Although individual patrons are allowed to act as the player-dealer, doing so may carry a financial risk, and consequently an entire industry has emerged to serve this role. Businesses known as third-party proposition player companies (third-party companies) enter into contracts with card rooms and employ staff who, as Figure 1 shows, take on the role of the player-dealer at game tables. These companies also employ personnel who supervise their players and distribute money to games. Third-party companies have been subject to regulation since 2003, and in fiscal year 2017–18, they represented a large portion of all gaming license applications.

### The Licensing Process

The bureau, the commission, and the Indian and Gaming Law Section (IGLS)—a separate division of Justice—each have responsibilities in determining whether to issue licenses to applicants. Figure 2 outlines the roles each of these parties play in the regulation of card rooms and third-party companies, and we describe these roles in detail in the sections that follow.

**Figure 2**  
The Bureau, the Commission, and IGLS Share Licensing Responsibilities



Source: Business and Professions Code; California Code of Regulations, title 4, section 12002 et seq.; California Code of Regulations, title 11, section 2000 et seq.; and bureau, Justice, and commission policies.

<sup>2</sup> The prohibition on banked gaming, in which establishments have a stake in the games' outcomes, distinguishes card rooms from casinos operated by federally recognized tribes. These tribes can enter into agreements with the State that allow them to offer banked gaming and slot machines in their casinos.

### ***The Bureau***

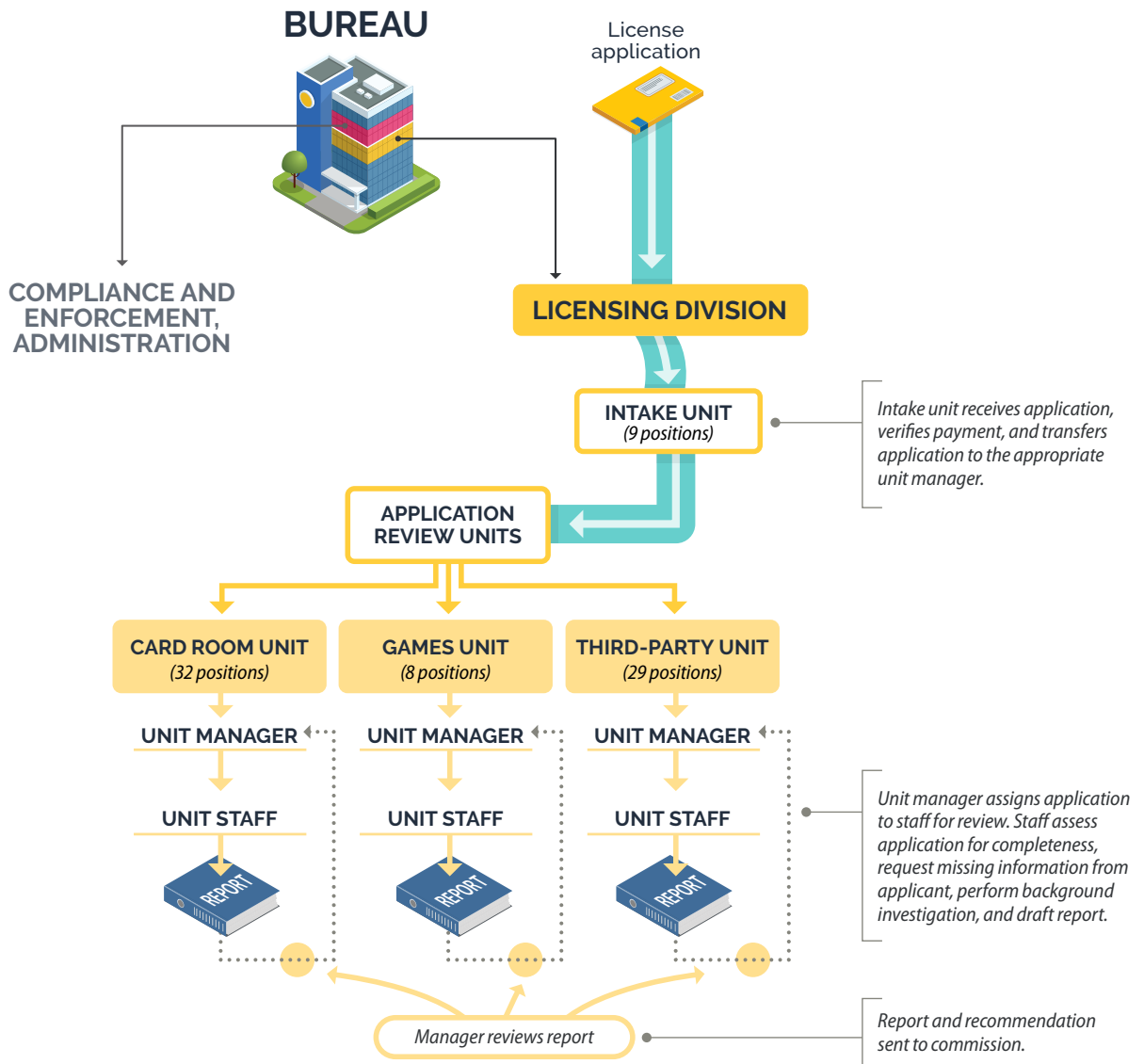
To begin the process, applicants first submit their applications to the bureau, along with payment of any applicable fees. The application forms vary by license type, but most require information about the applicants' employment history and criminal background. Because the Gambling Act prohibits certain individuals from holding licenses, including those with felony convictions or who have been convicted within the past 10 years of offenses classified as crimes involving moral turpitude or dishonesty, the bureau must recommend denial for applicants with such convictions. Some license types also require other types of information, such as the applicants' personal financial history. In general, the higher the level of responsibility the license holder will hold in the industry, the more detailed the application materials and subsequent review are.

The bureau has multiple units under its licensing division, each of which is responsible for either a specific step in the process or for a specific type of application. Figure 3 shows the structure of the bureau's licensing division, as well as its general process for handling applications. The bureau's intake unit receives all initial applications and license renewals. This unit performs certain administrative tasks, such as verifying application fees, before forwarding the applications to one of the three application review units: one focuses on card room owners and their employees, one on the games that card rooms offer, and one on third-party company applications. According to the bureau's assistant director for licensing (licensing director), managers in the application review units are responsible for assigning individual applications to staff. Although the bureau has no formal protocols for how managers assign applications, managers told us they generally do so in the order in which the applications arrive. Managers also told us that as a general rule, staff in different licensing units do not assist with each other's applications.

Once applications are assigned, bureau staff conduct background investigations on the applicants to help determine their suitability to hold gaming licenses. Figure 4 provides some example steps in the background investigation process. Although these steps vary depending on the type of license, the bureau's procedures generally direct staff to identify and inquire about criminal convictions or apparent issues with applicants' employment histories, such as previous terminations, as part of investigating the applicants' suitability for licensing. The bureau's procedures further instruct staff to review all applicants' fingerprint results and to request database inquiries from agencies such as the Department of Motor Vehicles to identify past infractions or outstanding fines. Some processes may require staff to follow up

for additional information. For example, when an applicant has a criminal history, staff may need to request records from the court that convicted the applicant. For more involved applications, such as those for card room and third-party company owners, staff also review and follow up on financial issues, such as bankruptcy filings or loans.

**Figure 3**  
The Bureau Has a Structure and Process for Reviewing License Applications



Source: Bureau organizational charts and licensing division procedures.

Note 1: Position totals include vacancies and only positions funded by the Gambling Fund.

Note 2: The Games Unit and Intake Unit have the same manager but are different units. The manager is included in the position count of the Intake Unit.

**Figure 4**  
The Bureau's Background Investigation Process Can Include Numerous Steps



Source: Bureau background investigation procedures.

Note: This list does not include all of the steps the bureau takes in its background investigations, nor does the bureau perform all of the steps above for all applicants.

In most cases, the bureau has 180 days to complete its investigation process after receiving a complete application. When an investigation is complete, the bureau issues a report and accompanying licensing recommendation to the commission.<sup>3</sup> For most application types, applicants must submit a deposit to cover the costs of the bureau's background investigation. Bureau staff use a time-reporting system to account for the time and costs involved in reviewing each application, and the bureau refunds any unused portion of the deposit. If a background investigation's costs exceed the amount of the deposit, state law allows the bureau to request additional funds from the applicant.

### ***The Commission***

After the commission receives the bureau's report, it schedules the applicant for consideration by the five commissioners. Appointed by the Governor and confirmed by the Senate, the commissioners are responsible for granting or denying most initial gaming license applications within 120 days of receiving the bureau's report—which, combined with the bureau's 180-day period, means that processing a license can take 300 days even if all time frames are met. The commissioners make certain decisions during their regularly scheduled licensing meetings, which they hold roughly

<sup>3</sup> An exception is the bureau's processing of applications for the licensing of games, for which it makes the final approval decisions.



every two weeks. The commission's records indicate that the commissioners consider an average of more than 200 card room and third-party company applications at each of these meetings and approve the majority of them.

The commissioners may also decide to refer applicants to evidentiary hearings for a more involved consideration of their suitability. These hearings, which the commissioners oversee, involve sworn testimony by applicants, who may have legal representation if they choose to do so. Apart from mandating the denials that we describe on page 8, the Gambling Act gives the commission broad discretion in making determinations about individual applicants, requiring the commissioners to be satisfied with the applicant's character, honesty, and integrity.

### ***IGLS***

IGLS performs a range of tasks for the bureau related to card rooms and third-party companies. For example, at the commission's evidentiary hearings, IGLS attorneys present legal arguments in support of the bureau's licensing recommendations and evidence the bureau obtained during background investigations. In the past, another key IGLS responsibility has involved the review of legal documents associated with applications for owner licenses. Applicants for owner licenses are generally attempting to purchase all or part of card rooms or third-party companies or to transfer existing ownership to a legal trust. Along with their applications, these individuals submit legal and contractual ownership documents, such as purchase agreements, financial documents, and trust documents. Until October 2018, IGLS was responsible for performing legal reviews of these transaction documents before the bureau forwarded its licensing recommendations to the commission. At that time, however, the bureau hired an in-house deputy attorney general (in-house attorney) to process all its legal reviews of transaction documents in an effort to expedite these reviews.

### **Enforcement Responsibilities**

In addition to processing license applications, the bureau is responsible for enforcing card rooms' and third-party companies' compliance with state laws and regulations. The bureau's Compliance and Enforcement Section (compliance section) conducts routine inspections of card rooms in which staff verify compliance with regulatory and legal requirements, such as the need to post signs that feature responsible gambling messages. Staff also verify the

appropriateness of the number of tables in use and of the limits on wagering. In addition, bureau special agents may conduct investigations into suspected illegal activities at the bureau's discretion, in response to complaints, or in cooperation with other law enforcement agencies.

The bureau reports card room violations it identifies to the commission. Depending on the nature of the violations, the commissioners may review them in the context of licensing decisions, or the violations may be litigated in front of an administrative law judge. When a violation goes before an administrative law judge, IGLS attorneys represent the bureau at the administrative hearing. Ultimately, however, the commissioners are responsible for making the final determination regarding the violations, including about any disciplinary actions recommended by the administrative law judge, which can include license revocation or fines.

### **Equal Treatment of Applicants and Licensees**

When the Joint Legislative Audit Committee (Audit Committee) approved this audit, it expressed concerns that the bureau and the commission may be treating certain applicants and license holders differently on the basis of race or ethnicity. The Audit Committee directed us to determine whether the bureau and commission have and adhere to policies and procedures to ensure all applicants and licensees are treated fairly and consistently. Because neither the bureau nor the commission comprehensively track the ethnicity of the applicants and license holders they regulate, we were unable to determine with certainty whether systematic discrimination has taken place. However, our review of individual applicant files did not identify evidence of discrimination on the basis of ethnicity or other related characteristics.

Nonetheless, as the subsequent sections of this report discuss, this audit found practices at both the bureau and commission that subjected applicants and licensees to inconsistent and unequal treatment. We found issues at both entities with the timeliness of their application reviews and the costs applicants and licensees paid. We also identified inconsistencies in the level of scrutiny to which the bureau subjected applicants. Some of these practices stemmed from missing or incomplete policies and procedures. As long as the bureau and commission allow inconsistencies in their practices, they risk fostering the perception that they may engage in discriminatory acts.

## The Bureau's and Commission's Inefficiencies Have Driven Delays and Compounded Backlogs in the Licensing Process

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### Key Points

- The bureau has regularly exceeded the statutory 180-day time frame for completing its review of license applications, and it has also failed to notify applicants of their status at required points. Although the bureau asserted that the delays were the result of a lack of resources, it could process applications more quickly if it effectively screened them for completeness when it first received them.
- The bureau has elected to stop issuing decisions on certain games applications, which has placed some card room owners at an economic disadvantage by preventing them from offering games that the bureau approved for their competitors.
- Since July 2015, the bureau has more than doubled its staffing to address its backlog of license applications. Nevertheless, as of December 2018, it still had a backlog of nearly 1,000 applications. The bureau's productivity has diminished since it hired additional staff, raising questions about the level of staffing it needs to process applications.
- As a result of its referral of an increasing number of applicants to evidentiary hearings and of conflicting regulations, the commission has repeatedly failed to meet the requirement that it approve or deny most applications within 120 days of receiving the bureau's recommendations.

### The Bureau Has Failed to Establish Processes That Might Help It Address Licensing Delays

The bureau has regularly exceeded statutory time frames for processing gaming license applications. As Table 1 demonstrates, the bureau's data indicate that it exceeded the 180-day time frame for 3,521, or 70 percent, of the 5,012 applications it reviewed from January 2014 through December 2018. Some of these delays spanned years: in fact, 46 applications took longer than six years to complete. Similarly, the bureau exceeded the 180-day time frame to complete its review of 16 of the 23 application files we reviewed, with one review taking more than 2,300 days—over six years.

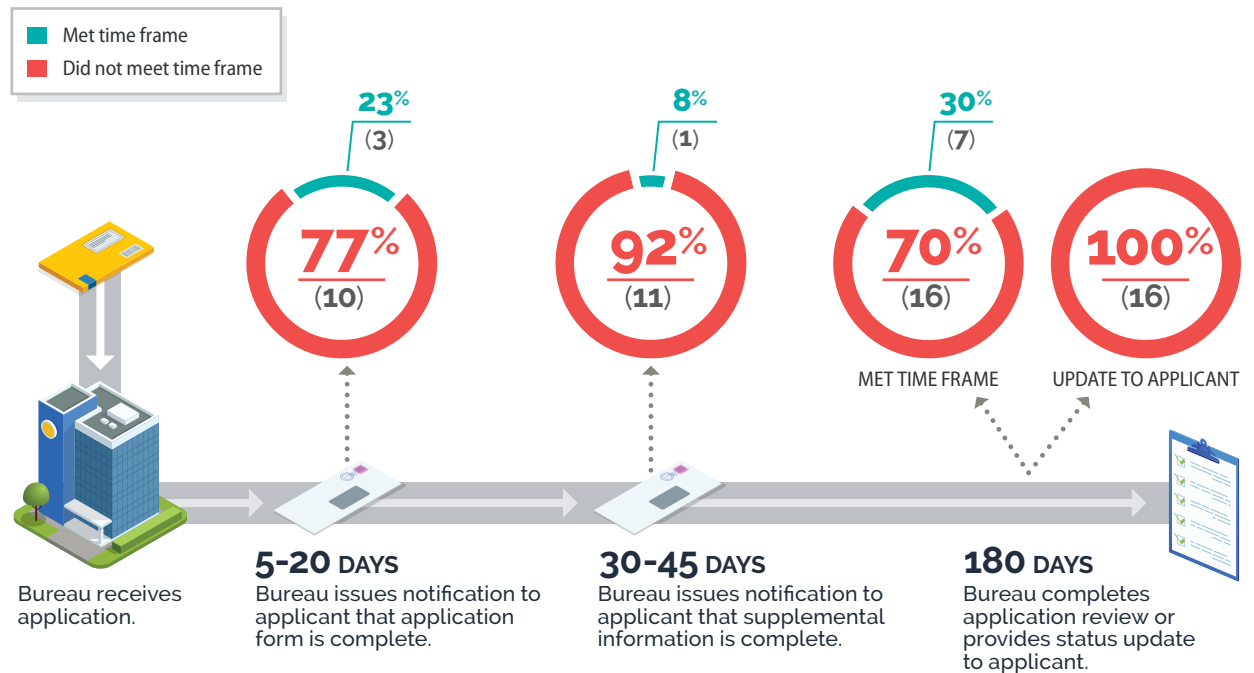
The bureau also rarely provided the applicants we reviewed with required notifications. Once an application review reaches 180 days, state law requires the bureau to give the applicant an update on the status of the application and the estimated time to completion. However, the bureau failed to provide such updates to any of the 16 applicants we reviewed whose applications took longer than 180 days. For certain types of licenses, regulations also require the bureau to notify applicants within five to 20 days if the applications they have submitted are complete and

within 30 to 45 days if the applications include all required supplemental information, such as employment history and financial records. However, the bureau failed to meet the pertinent deadlines for 10 of the 13 applications we reviewed in which the first time frame applied and 11 of the 12 in which the second time frame applied. Figure 5 summarizes the bureau's compliance with relevant time frames for the applications we reviewed.

**Table 1**  
The Bureau Exceeded the 180-day Time Frame for the Majority of the Applications It Reviewed in the Past Five Years

LENGTH OF TIME TO REVIEW	LICENSE TYPE				TOTAL REVIEWED
	CARD ROOM		THIRD-PARTY		
	EMPLOYEES	OWNERS	EMPLOYEES	OWNERS	
180 Days or Fewer	352	40	1,099	–	1,491
181 Days to 1 Year	180	58	1,432	–	1,670
> 1 Year to 2 Years	384	122	764	2	1,272
> 2 Years to 3 Years	10	68	250	1	329
> 3 Years to 4 Years	1	31	93	1	126
> 4 Years to 5 Years	1	7	15	–	23
> 5 Years to 6 Years	–	5	49	1	55
Greater Than 6 Years	–	4	39	3	46
<i>Subtotals of applications taking more than 180 days</i>	<i>576</i>	<i>295</i>	<i>2,642</i>	<i>8</i>	<i>3,521</i>
<b>Totals</b>	<b>928</b>	<b>335</b>	<b>3,741</b>	<b>8</b>	<b>5,012</b>

Source: Analysis of bureau data on license applications it completed from January 2014 through December 2018.

**Figure 5****In Most Cases, the Bureau Did Not Meet Required Time Frames for Processing the 23 Applications We Reviewed**

Source: Business and Professions Code; California Code of Regulations, title 4, section 12002 et seq.; and review of case files at the bureau.

Note: The length of time the bureau has to notify applicants whether their applications and supplemental information is complete varies by license type. Not all license types have these notification requirements, which is why not all of the above time frames apply to all 23 applications.

The bureau's failure to promptly determine whether applications were complete likely exacerbated at least some of its delays in processing the applications we reviewed. In one case, the bureau sent an applicant eight letters over two years requesting different types of missing and additional documentation. The bureau then took so long to assess the information that the applicant provided that staff ultimately asked for bank statements for an additional year and tax returns for two additional years. The bureau also took long periods of time between its requests to the applicant; in one instance, it waited nine months between requests and, in another instance, nearly a year.

Similarly, when the bureau was processing an application that it spent more than six years reviewing, it made multiple requests for additional information from the applicant. The bureau's files show that this applicant communicated his frustration with the length of the background investigation process and, at one point, requested an update of the bureau's estimated time to completion. However, the available documentation does not show that the bureau responded to this request. Although some of the letters in one of these cases

included follow-ups to initial requests that the applicants had not met, some of the correspondence in both cases also requested new documentation. Failing to promptly and effectively assess the completeness of submitted applications and supplemental information leads to back-and-forth interactions that compound delays and create more work for the applicants and the bureau.

Although the licensing director cited the bureau's lack of available resources to assign cases to as contributing to the processing delays in several of the applications we reviewed, we found that the bureau could take steps to increase its efficiency. For example, it has not developed a process to screen applications as it receives them to determine if they are complete. Although the bureau's intake unit receives and sets up files for applications, it does not evaluate the applications' completeness. Instead, licensing staff make these assessments when they begin working on the applications. An evaluation of the completeness of an application at the beginning of the process would allow the bureau to request missing documentation earlier and enable licensing staff to begin their reviews more quickly.

Moreover, we identified other ways in which the bureau could improve its application review process. Although the bureau has written guidelines that list the steps licensing staff must take when performing background investigations, a licensing manager told us that the bureau lacks written guidelines to guide managers when prioritizing the applications they assign to staff. In addition, she stated that the bureau has not completed a review to determine what particular steps within the background investigation process may be contributing to delays. If the bureau identified the portions of its background investigation process—such as reviewing criminal histories or requesting court documents—that most commonly cause delays, it could implement changes that might improve its timeliness in processing applications.

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**The bureau has not completed a review to determine what steps within the background investigation process may be contributing to delays.**

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Lengthy delays have different implications for different types of applicants. Under state regulations, the commission may issue temporary licenses to individuals who apply to work in nonownership positions in the industry. These temporary licenses—which usually require the bureau only to check the applicants'

fingerprints for criminal history—allow the individuals to work while the bureau investigates their license applications. However, lengthy delays in completing investigations of these applicants creates the risk that individuals for whom the bureau will ultimately recommend denials will inappropriately work in the industry for a prolonged period. In one extreme case, an applicant worked in the gaming industry as a registrant—a temporary status for third-party applicants—for more than five years before the bureau recommended that the commission deny his license. This applicant had failed to disclose information in his application, and his third-party business had violations that included improperly kept records and inappropriate financial transactions.

In contrast, the lengthy process for issuing licenses to card room owners can create hardships for some applicants. Although these applicants can apply for temporary licenses, the bureau's process for reviewing the temporary applications involves significant additional steps, such as reviewing the source of funds for the purchase of the card room business and a legal review of any ownership documents by IGLS. These practices are based upon procedures agreed to by the bureau and commission, and the bureau has since noted to the commission that reviewing temporary applications is time-consuming and just short of a full background investigation. Temporary licenses for card room owners are also relatively rare. As of December 2018, the bureau's licensing data indicated that it had 203 pending initial owner applications, including applications that dated back as far as 2014. Nonetheless, at that time, it had completed only 23 temporary license requests for card room owners in the previous four years and had six other temporary owner license requests in process. The delays owners and potential owners face mean they may miss opportunities to acquire card rooms or lose revenue while waiting for the licenses that would allow them to operate the card rooms.

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**The lengthy process for issuing licenses to card room owners can create hardships for some applicants.**

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Applicants for card room owner licenses are also likely to face long and inconsistent wait times in part because of the process the bureau uses to review these applications. For example, the bureau has not developed a formal process to prioritize the assigning of owner applications to staff for their review. In the absence of such a process, managers indicated that they generally assign applications

in the order in which they are received. However, when we reviewed seven owner applications, we found that the time that managers took to assign them to staff ranged from as few as 19 days to as long as 510 days and that managers did not always assign them in the order they were received. According to the bureau's card room licensing manager, the bureau may assign some owner applications out of order because of extenuating circumstances. For example, it expedited one review because of the failing health of an applicant who was requesting to transfer ownership interest to a family member. In addition, according to another licensing manager, the bureau may prioritize applications either if owners die and there is a question about who will take over the licenses or if owners have had licenses revoked or denied and the commission has set a time limit for them to sell the card rooms.

However, the bureau did not provide consistent rationales for its lengthy delays in assigning some applications but not others. For instance, it received two applications in the same month but assigned one nearly a year later than the other. A manager explained that the bureau assigned the first application 87 days after receiving it to prevent a card room license from expiring. This manager also explained that the bureau was able to assign the application so quickly because it was adequately staffed at the time. However, when we asked why the second application—which the bureau had received two days earlier—was not assigned for nearly a year, the manager cited a lack of staff.

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**The bureau did not provide consistent rationales for its lengthy delays in assigning some applications but not others.**

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The time the bureau took to assign owner applications was not the only cause of delays that we observed. As we discuss in the Introduction, until recently the bureau relied on attorneys from IGLS, another section of Justice, to review legal transaction documents associated with owner applications, such as purchase agreements. In some of the cases we reviewed, the time it took IGLS to complete its reviews significantly contributed to the lengthy application process. The senior assistant attorney general who oversees IGLS explained that unless the bureau requests IGLS to complete reviews quickly or by a certain date, they are generally a lower priority than—for example—the complex litigation with court-imposed deadlines that IGLS performs. However, even though the bureau specified due dates for four of the six IGLS



requests that we reviewed, IGLS did not meet any of those due dates. Further, we found no evidence that the bureau attempted to hold IGLS to the due dates or that it consistently followed up with IGLS on the status of its legal reviews.

In October 2018, the bureau hired an in-house attorney so that it could begin performing its own legal reviews. IGLS's senior assistant attorney general stated that the bureau is no longer sending new requests for legal reviews, and the licensing manager explained that the bureau has withdrawn some of its pending requests from IGLS and reassigned them to the in-house attorney. With only one such attorney, the bureau should take steps to ensure its prioritization of legal reviews is as consistent and transparent as possible. Its past communications to IGLS, as well as our review, indicate that it has prioritized applications based on factors other than when it received them. However, it has done so without a formal process for weighing these extenuating factors, creating the risk that it may favor some applicants without sufficient reason. Now that the bureau is transitioning to in-house legal review of transaction documents, it should develop formal procedures for prioritizing the in-house attorney's workload and periodically assessing whether one attorney is sufficient to process legal reviews in a timely manner.

### **The Bureau's Approach to Processing Applications for Certain Games Has Disadvantaged Some Card Room Owners**

For three years, the bureau has not issued any decisions on card rooms' applications for certain types of table games known as California games, which we describe in the Introduction. Instead, according to its records as of March 2019, it had a backlog of 99 such applications.<sup>4</sup> According to state law, the bureau has sole responsibility for the approval of card room games and their rules. A bureau manager stated that it reviews and approves each game on an individual card room basis.

The reason the bureau has not approved any new California games applications has to do with restrictions in state law about the games that card rooms can offer. As the Introduction explains, state law prohibits card rooms from the practice of game banking, when the gaming establishment employs the dealer and acts as the house by paying the winning players and collecting from the losing players. However, state law does not consider a game to be banked if its rules include a player-dealer position held by someone who is not

<sup>4</sup> These applications include requests from card rooms to offer new games, as well as to change the rules of existing games.

a card room employee and if that position is continuously and systematically rotated among each of the participants during play. To help fill these player-dealer positions, card room owners may contract with third-party companies. In response to a question from gaming industry interest groups, a former bureau chief issued a letter in 2007 specifying the bureau's interpretation of the legislative intent behind the state law—which stated that as long as the opportunity to act as the player-dealer position is continuously and systematically offered to all players, the fact that at times, all players but one may decline the player-dealer position does not make the game illegal.

However, in February 2016, the bureau issued a notification to all California card rooms regarding changes in its approach to the rules of games featuring a player-dealer position. The rotation of the player-dealer position is important because if other players in a game choose not to accept the offer of the player-dealer position, then a single individual effectively becomes the house, banking the game in the process—which is prohibited. Therefore, the bureau's letter informed card rooms that it would no longer approve any new game rules if those rules permit only offering rotation of the player-dealer position. The bureau issued a notification of the revised enforcement and game-approval processes relating to the rotation of the player-dealer position on June 30, 2016. A card room and a third-party business objected and, in January 2017, submitted a petition challenging the notification to the Office of Administrative Law. The Office of Administrative Law ruled in July 2017 that the bureau's change in approach required it to enact regulations, which it has not yet done.

The bureau's decision to not act on new requests for these California games—as well as its delay in issuing regulations—has placed some card rooms at an economic disadvantage because they cannot offer games that the bureau approved for other establishments before the current suspension. Therefore, these card rooms' competitors may offer games that they do not. The bureau is currently holding workshops to receive input on rotation of the player-dealer position before it initiates the formal regulation process, and its licensing director told us that it is in the early stages of drafting regulations. Despite the fact that its moratorium on reviewing these applications has now lasted more than three years, the bureau's director stated that the bureau does not have an estimated date by which it will complete the regulations because several steps still remain in the regulatory process. However, the director also stated that the bureau plans to introduce draft regulatory language at another workshop within the next few months.

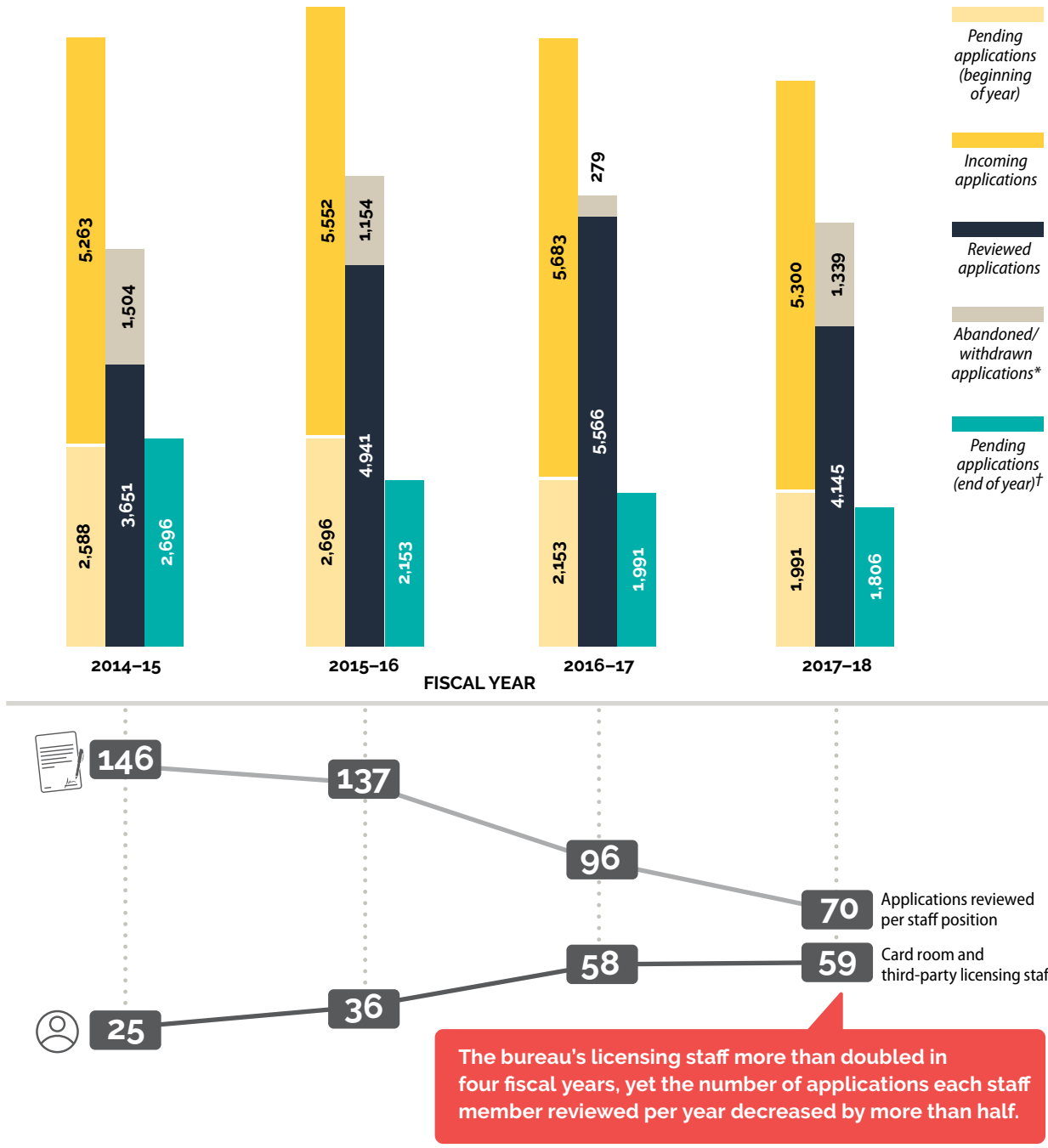
When we expressed concerns about the impact of the delays on card rooms, the licensing director stated that the bureau intends to issue temporary approvals for these types of games once it has resolved an unrelated rules issue concerning blackjack-style games. According to the director, the bureau decided to handle both the rotation of the player-dealer position and the blackjack-style game rules at the same time, and it did not begin a formal review of the blackjack-style games rules until August 2018. Because such a significant amount of time has passed since the bureau stopped issuing decisions on California games, it is critical for the bureau to act as quickly as possible to provide card room owners with equal access to approved games.

### **Despite Significant Staff Increases, the Bureau Has Made Only Moderate Progress in Reviewing Pending Applications**

Since July 2015, the bureau has significantly increased its licensing staff. Starting in fiscal year 2015–16, the Department of Finance (Finance) and the Legislature approved the bureau’s request for three years of funding for 12 additional positions. When requesting these additional positions, the bureau’s justification was its large number of pending license applications—which comprise all applications that are in progress, including those that are more than 180 days old and therefore backlogged. The bureau initially projected that with this increase in staff, it would be able to complete its review of the pending applications by June 2018. The Legislature then approved three years of temporary funding for an additional 20 positions starting in fiscal year 2016–17. The bureau placed the additional staff in its card room and third-party licensing units, which are responsible for the review of pending applications. The additional positions helped the bureau to more than double its card room and third-party licensing staff, from 25 in June 2015 to 58 in June 2017.

However, the bureau has made only moderate progress in clearing its pending license applications. Figure 6 shows the bureau’s workload and progress over the past several years: the number of incoming applications increased only marginally in fiscal years 2015–16 and 2016–17, and it actually decreased in fiscal year 2017–18. Despite the small growth in incoming applications and the bureau’s reviewing more total applications after receiving additional staff, a sizeable number of pending applications remains. Specifically, although the number of pending applications has decreased considerably from a high of 2,700 in June 2015, the bureau still had more than 1,800 as of June 2018.

**Figure 6**  
As a Result of Declining Productivity, the Bureau Has Continued to Have a Sizeable Number of Pending Applications



Source: The bureau's licensing data and organizational charts for fiscal years 2014-15 through 2017-18.

\* The bureau believes that a large majority of these applicants are third-party registrants who did not submit license applications. According to the bureau, an application is abandoned when the bureau receives notice that the applicant is no longer employed (for example, by the third-party company). Applicants may also request to withdraw their applications.

† Pending applications include all applications that are not completed.

Our review found that a decrease in the average productivity per licensing staff position caused this persistently high number of pending applications. As Figure 6 shows, although the bureau's licensing staff in the card room and third-party licensing units increased from 25 in fiscal year 2014–15 to 36 in fiscal year 2015–16, the average number of applications that each staff person reviewed decreased from 146 to 137. In fiscal year 2016–17, the bureau reviewed only 96 applications per filled position; in fiscal year 2017–18, that number decreased again to just 70 applications. Thus, in the course of three years, the average number of applications each staff member reviewed dropped by more than half, significantly diminishing the relative impact of additional staffing on the license application backlog. This decrease in productivity makes us question how effectively the bureau has utilized the resources the Legislature has provided to it.

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**A decrease in the average productivity per licensing staff position caused this persistently high number of pending applications.**

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According to the licensing director, the bureau initially directed a majority of its new positions, as well as significant overtime hours, to the unit that handles third-party license applications. The initial focus on the third-party unit was to prioritize the review of third-party player applications, which comprised most of the pending applications. From fiscal years 2015–16 through 2016–17, the number of third-party player applications the bureau reviewed annually rose from 390 to 1,500. However, this number decreased to 1,000 in fiscal year 2017–18.

According to the manager for the third-party unit, this decrease occurred in part because the bureau redirected licensing staff working on third-party player applications to focus on more complex and time-consuming third-party owner applications. The manager explained that the bureau changed its focus under the rationale that third-party owners pose greater potential risk to the public if not subjected to thorough background investigations because third-party owners decide the card rooms with which to enter into financial arrangements. According to the manager, the bureau has found that some third-party owners are using outside financial arrangements to funnel money to card rooms outside of bureau-approved contracts. Although the bureau's reasoning for shifting staff is reasonable, it has not produced the expected results: the bureau did not actually complete reviews of any third-party owner applications in fiscal year 2017–18.

In addition, although the bureau has nearly doubled the number of staff in its card room unit since July 2015, that unit's overall productivity has actually decreased. In fiscal year 2015–16, the card room unit reviewed 560 initial applications. In fiscal year 2016–17, it reviewed 430 applications, and in fiscal year 2017–18, it reviewed only 400, despite adding staff each year. The manager of the card room unit stated that she was not sure why the unit's production level dropped. However, she indicated that the time required to train the new staff might have reduced the unit's productivity.

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**Although the bureau has doubled the number of staff in its card room unit, that unit's overall productivity has decreased.**

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As a result of the bureau's failure to use its additional staff to proportionately increase its productivity, many applications have been pending for years. As of December 2018, the bureau had more than 1,700 applications pending, 957 of which had been at the bureau for longer than 180 days and thus were part of its backlog. Table 2 provides the length of time applications had been backlogged as of December 2018, summarized by application type. Notably, 97 third-party license applications had been backlogged for more than five years. These numbers indicate that the bureau has struggled to clear out the older applications that it cited in its 2015 budget change proposal as the basis for requesting additional staff.

Our concerns about the decreasing productivity in the card room and third-party units is consistent with increases in the number of hours that the bureau has reported that it takes to review a single application. In its fiscal year 2015–16 budget change proposal to Finance, the bureau provided estimates of the average hours it spent reviewing a single application for each license type. In June 2018, the bureau updated its estimates for several license types, significantly increasing the average hours for each. For example, it nearly tripled the average hours to review a third-party player application, from eight to 22 hours. The average hours to complete a third-party supervisor application increased from 56 hours to 128 hours. These increases are consistent with the fact that the bureau has been reviewing fewer applications per licensing position than it was in fiscal year 2014–15. The bureau has not yet updated its per-application time estimates for reviewing many license types, including third-party owner licenses and nearly all card room licenses.

**Table 2**  
**Many Card Room and Third-Party Applications Have Been Backlogged for Years**

LENGTH OF TIME PENDING (YEAR RECEIVED)	LICENSE TYPE					TOTAL PENDING
	CARD ROOM			THIRD-PARTY		
	EMPLOYEES	OWNERS	OTHER	EMPLOYEES	OWNERS	
180 Days or Fewer (2018)	77	18	2	650	5	752
181 Days to 1 Year (2018)	49	61	0	310	6	426
> 1 Year to 2 Years (2017)	49	73	0	119	12	253
> 2 Years to 3 Years (2016)	5	34	0	59	9	107
> 3 Years to 4 Years (2015)	0	16	0	30	10	56
> 4 Years to 5 Years (2014)	0	1	0	14	3	18
> 5 Years to 6 Years (2013)	0	0	0	21	8	29
Greater Than 6 Years (2010–12)	0	0	0	16	52	68
<b>Totals</b>	<b>180</b>	<b>203</b>	<b>2</b>	<b>1,219</b>	<b>105</b>	<b>1,709</b>
						<b>957</b>
						<b>Total Backlogged (pending more than 180 days)</b>

Source: Bureau data and analysis of pending applications as of December 2018.

The bureau has not sufficiently demonstrated the number of permanent card room and third-party licensing staff it needs to clear the backlog, prevent it from recurring, and deliver services at the lowest cost to the State. In fiscal year 2018–19, the bureau submitted a budget change proposal to Finance to make permanent the funding for the 12 positions that the Legislature approved in fiscal year 2015–16. When it did so, it provided a new estimate that it would be able to review all pending applications and thereby eliminate the backlog by June 2023. However, given its inability to meet its original goal of June 2018 and its diminishing productivity since it set that goal in 2015, we have concerns about the bureau’s ability to meet this new goal.

In response to the bureau’s fiscal year 2018–19 request, the Legislature chose to extend the funding for the 12 positions for an additional year rather than make it permanent. When it did so, legislative staff noted that determining the appropriate level of ongoing resources the bureau needed to eliminate the backlog and prevent future backlogs was difficult because the full impact of the positions was still unclear. Our

audit indicates that adequate staffing is not the only issue hampering the bureau's efforts to address its large number of pending applications. In the previous section, we identify inefficiencies in the bureau's current approach to reviewing applications that contribute to delays. Later in this report, we discuss our review of staff time reporting, which indicates that licensing staff spend considerable amounts of time performing activities that are unrelated to reviewing applications. With the funding for all 32 additional positions expiring in June 2019, we believe it is premature to make that funding permanent.

If the bureau addresses the inefficiencies we discuss throughout this report, we estimate that it currently has a sufficient number of total staff to clear its pending applications relatively quickly. Taking into account the number of incoming applications and using the number of licensing staff as of January 2019 and the bureau's average productivity per licensing staff over the last five fiscal years, we estimate that the bureau should be able to clear about 6,600 applications each year. This amount, which represents a 19 percent increase in reviewed applications from the bureau's projection in its fiscal year 2018–19 budget proposal, would allow the bureau to clear the existing pending applications by the end of fiscal year 2020–21. Changes in the composition of the types of applications the bureau reviews and any decrease in its filled licensing positions because of staff turnover could cause the bureau's actual number of reviewed applications to be lower. The bureau will need to account for its actual future productivity by addressing its inefficiencies and developing a formal plan for reviewing the remaining backlogged applications.

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**We estimate that the bureau should be able to clear about 6,600 applications each year.**

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Once it has cleared its pending applications, the bureau is likely to need some of the 32 positions on a permanent basis. Based on average staff productivity and the average number of incoming applications over the past five fiscal years, we estimate that it would require permanent funding for 19 of the 32 positions. However, after the bureau addresses the inefficiencies we identify in this report, this number is likely to decrease. Once the bureau clears the existing pending applications and takes steps to improve its productivity, it can reassess how many positions it needs on a permanent basis.

Beginning in fiscal year 2017–18, the commission also received approval for three temporary positions in anticipation of the bureau's forwarding it an increased number of applications. The commission's



executive director indicated that the number of applications the bureau has sent has increased; however, the commission does not currently have comprehensive data regarding the number of incoming licensing applications or the outcomes of those applications, such as how many it has denied or approved. According to the deputy director of the licensing section, the commission has thus far not needed all three temporary positions to complete its workload. However, if the bureau takes the steps we recommend, the commission will likely see an increased workload in the coming fiscal years.

### **The Commission's Regulatory Process for Denying Applications Has Created Delays and Inefficiencies**

The commission's process for denying applications causes it to exceed regulatory time frames, which require it to approve or deny most applications within 120 days of receiving the bureau's reports. Our review of 18 applications found that the commission met the 120-day time frame for applications it approved at regular licensing meetings. However, primarily because of its practice of referring all possible denials to evidentiary hearings, it did not meet the time frame for those applications that it denied. Although the commission approves the majority of all applications, its delays in reaching denials have been significant. The commission referred seven of the 18 applications we reviewed to evidentiary hearings. Those applicants waited an average of 258 days for decisions, compared to an average of just 52 days for applicants for whom the commissioners made licensing decisions at regular meetings. According to a commission tracking document, it denies about 75 percent of all applicants it refers to evidentiary hearings.

The commission's failure to meet the required time frame is in part because of conflicting regulations that it established. In 2015 the commission amended its regulations to require hearings for all denials. When it did so, the commission established new time frames for cases it refers to hearings, requiring a minimum of 60 days' notice to an applicant in advance of a hearing and allowing up to 75 days from the hearing's conclusion to issue its decision—a total of 135 days. The allowance of 135 days introduced a potential conflict with the existing 120-day requirement. The commission's executive director told us that not updating the existing time frame when it revised its regulations related to hearings was an oversight but that it intends to make this change.

Before 2015 the commission could vote to preliminarily deny an application during its regular licensing meeting and would provide the applicant the opportunity to request a hearing if the applicant desired one. If the applicant did not request a hearing, then the commission's preliminary decision became final. We believe this

approach does not pose a due process concern for applicants because it still provides evidentiary hearings for those who request them. However, the commission's chief counsel explained that the commission amended its hearing regulations to conform to state law that requires the commission to conduct certain processes—such as taking oral evidence under oath and providing the opportunity for each party to call, examine, and cross-examine witnesses—during the meeting in which the commission approves or denies the application. To comply with this definition of a meeting, at least for denials, the commission began referring all possible denials to hearings.

Based on a review of the relevant state law, we agree that the commission's decision to require an evidentiary hearing if it contemplates a denial is reasonable, although we have concerns with the consequences of the law's requirements. Further, commission regulations still allow it to approve licenses during regular meetings; however, the law governing requirements at commission meetings does not distinguish between the requirements for approvals versus denials. Thus, by statute, both approvals and denials require an evidentiary hearing. Therefore, a clarification to the law is necessary to establish what actions the commission is authorized to take during its regular meetings so that it does not need to hold a hearing for every case.

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**The frequency of evidentiary hearings  
has increased substantially, from 12 in 2014  
to 34 in 2018.**

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The commission's 2015 change in approach has resulted in its use of considerable additional staff resources. Although the commission refers only a small fraction of the applications that it receives to evidentiary hearings, the frequency of evidentiary hearings has increased substantially, from 12 in 2014 to 34 in 2018. At each evidentiary hearing we reviewed, an attorney from IGLS presented the bureau's license recommendation to the commission. According to a time-reporting summary that the IGLS director provided, IGLS personnel spent nearly 4,000 hours preparing for and representing the bureau at hearings, including evidentiary hearings, during fiscal year 2017–18. Further, in addition to the IGLS attorneys and the commissioners, the commission's executive director and multiple legal staff usually attend the hearings. Considering that the evidentiary hearing is generally the second time the commission considers an application—having already seen it at one of its regular meetings—these individuals' time represents a significant additional investment.

Further, the additional resources needed to hold hearings may not provide any additional benefit in some situations. As we note previously, the commission referred seven of the 18 applicants we reviewed to evidentiary hearings. Of those seven applicants, four either informed the commission beforehand that they would not attend the hearings or stopped participating in the prehearing process. In three of these cases, the commission still held the hearings in the applicants' absence. According to its chief counsel, the commission moved forward with the hearings because the applicants did not explicitly waive their right to have a hearing. In fact, the commission does not have any official policies or procedures for determining or communicating to applicants what constitutes a formal withdrawal. We discuss the issue of holding hearings without applicants present in further detail later in this report. In addition, we see no added benefit from requiring hearings for applicants with mandatory disqualifying events, such as felony offenses. The extent to which unnecessary hearings contribute to delays and pose additional costs to the State demonstrates the need to clarify the Gambling Act.

## **Recommendations**

### ***Legislature***

Given that the bureau has not achieved the expected benefits from adding 32 additional positions, the Legislature should not approve any requests to make funding for these positions permanent. Instead, the Legislature should extend funding for an additional two years, during which time the bureau should be able to clear its existing number of pending applications. At that point, the Legislature should reevaluate the bureau's long-term staffing needs, taking into consideration the extent to which it has implemented the recommendations in this report.

To prevent delays and the unnecessary use of resources from requiring the commission to hold evidentiary hearings in all cases in order to deny applicants, the Legislature should amend the Gambling Act to allow the commission to take action at its regular licensing meetings rather than require it to hold evidentiary hearings.

### ***Bureau***

To avoid unnecessary delays in its licensing process, the bureau should, by November 2019, begin reviewing applications for completeness upon receiving them. If it determines that an application is incomplete, it should notify the applicant immediately.

To help it identify which portions of the background investigation process most contribute to lengthy delays, the bureau should conduct an analysis of its investigation processes by November 2019 and should implement procedural changes to improve its timeliness in processing applications.

To ensure that it approaches its remaining backlog strategically and that it establishes accountability for its use of resources, the bureau should develop and initiate a formal plan by November 2019 for completing the remaining backlogged applications. The plan should identify the license types the bureau will target and the order in which it will target them, along with its rationale for the planned approach. The plan should also include clear goals that identify the numbers of applications it will complete and its time frames for doing so.

To ensure that its licensing process is transparent and consistent, the bureau should implement formal procedures for prioritizing its completion of legal reviews of ownership applications. The procedures should specify any circumstances that justify reviewing applications out of the order in which the bureau received them.

To minimize the degree to which its process to change its regulations may result in the disparate treatment of card room owners, the bureau should temporarily approve or deny its backlogged games applications by July 2019.

### ***Commission***

To ensure that it has comprehensive licensing information to determine its ongoing workload and staffing needs, the commission should implement procedures for tracking the number of license applications it receives from the bureau each fiscal year and the outcomes of those applications, such as approvals and denials.

To prevent unnecessary delays and use of resources and to ensure its compliance with state law, the commission should, following the Legislature's amendment of the Gambling Act that we recommend, revise its regulations and policies for conducting evidentiary hearings. These revisions should specify that the commission may vote at regular meetings on a final basis to approve or deny licenses, registrations, permits, findings of suitability, or other matters and that it is not required to conduct evidentiary hearings unless applicants request that it do so.

## The Bureau and Commission Have Charged Fees That Do Not Align With Regulatory Costs, Resulting in an Excessive Surplus and Fairness Concerns

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### Key Points

- In possible violation of state law, the regulatory fees that the commission and bureau charge applicants, card room owners, and third-party company owners do not align with the costs of providing the related services. Specifically, the licensing revenue that the Gambling Fund receives from such fees covers less than half of the cost of processing license applications. In contrast, the other nonlicensing regulatory fees that card room owners and third-party company owners pay far exceed the costs of the related oversight.
- The balance in the Gambling Fund has doubled over the past five years, and the January 2019 Governor's proposed budget projects that its surplus will grow to more than \$97 million by June 2020. This excessively high projected balance is more than five times larger than the fund's annual expenses.
- The bureau's licensing staff often charge only a small portion of the time they spend conducting background investigations against the deposits the bureau collects from applicants, and they inconsistently request additional money from the applicants to cover actual costs. In addition to underscoring concerns about the efficiency of the bureau's operations, this practice means that applicants pay different amounts for services of the same value and type.
- In fiscal year 2017–18, the bureau's licensing staff charged nearly half of their time to activities that did not directly relate to the review of licensing applications. The bureau's failure to ensure that staff devote as much time and attention as possible to reviewing applications has likely contributed to the persistent backlog.

### The Fees That the Bureau and Commission Charge Do Not Align With Their Costs for Providing the Related Services

The Gambling Fund supports the costs that the bureau and commission incur while carrying out their respective duties and responsibilities. The Gambling Fund receives revenue primarily from licensing fees and other nonlicensing regulatory fees that the commission and bureau levy on license applicants, card room owners, and third-party company owners. Specifically, state law requires license applicants to pay nonrefundable application fees for all license types and refundable background investigation deposits for most license types. In addition, card rooms must also pay regulatory fees based on their number of gaming tables or gross revenue, while third-party owners pay fees based on their number of employees.<sup>5</sup>

<sup>5</sup> These card room fees are set in the Gambling Act as well as in the commission's regulations.

The Gambling Act defines the purposes of these fees broadly, stating that they shall be available upon appropriation by the Legislature to support the bureau and commission in carrying out their duties and responsibilities.

Regulatory fees must be reasonably related to the costs of the regulation involved. For example, state law requires that a license application include a deposit that is adequate to pay for the anticipated costs of the investigation and the processing of the application. In compliance with state law, the commission has adopted regulations that set nonrefundable fees for initial applications and renewals, and the bureau has established deposits to pay for the background investigations it conducts. For instance, an applicant for a card room owner license must pay a \$1,000 nonrefundable application fee and submit a \$6,600 deposit to cover the investigation. If an investigation costs less than the deposit, the bureau must refund any unused portion. If an investigation costs more, the bureau may require the applicant to deposit additional sums. Table 3 shows the costs for a selection of different licensing fees and deposits.

**Table 3**  
Licensing Application Fees and Background Investigation Deposits Vary by License Type

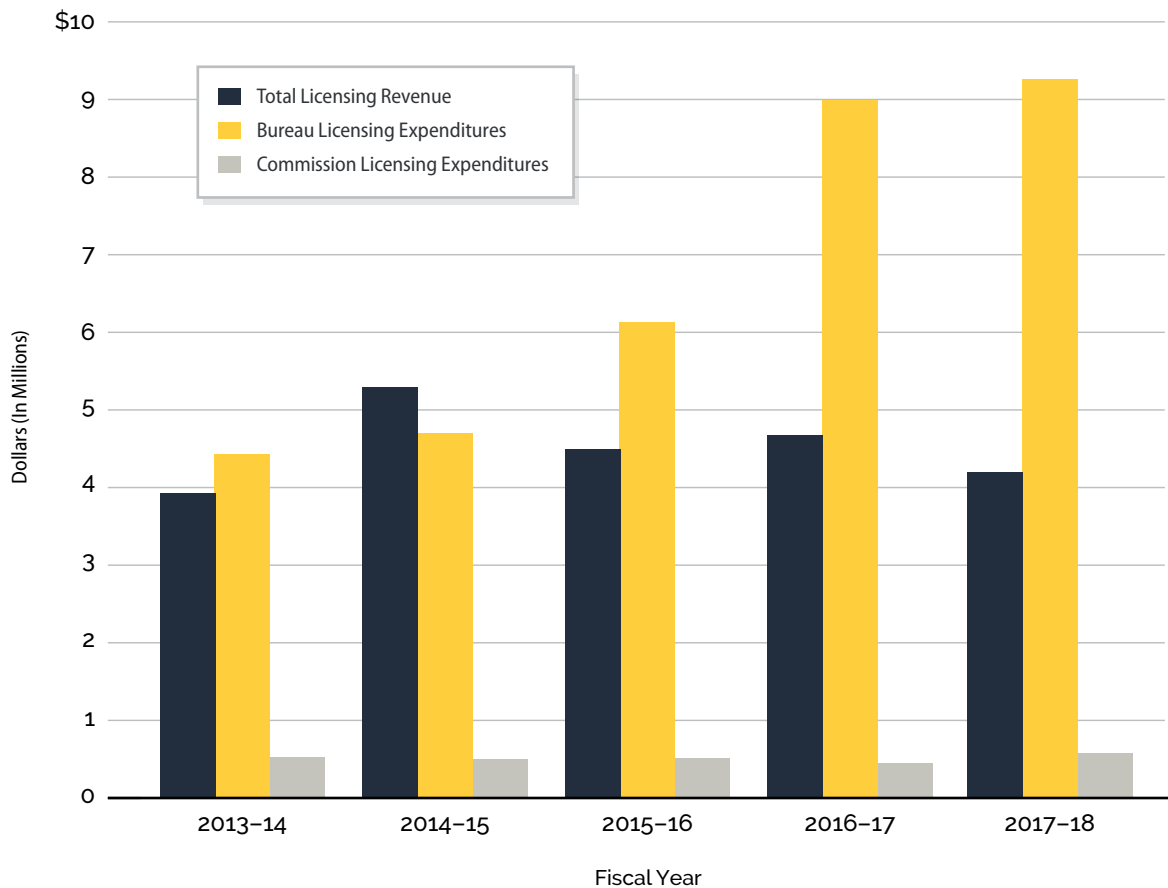
APPLICATION TYPE	INITIAL		RENEWAL	
	APPLICATION FEE	BACKGROUND INVESTIGATION DEPOSIT	APPLICATION FEE	BACKGROUND INVESTIGATION DEPOSIT
<i>Card Room Owner</i> (Individual or Entity)	\$1,000	\$6,600	\$1,000	\$725
<i>Card Room Owner</i> (Trust)	1,000	1,100	1,000	200
<i>Card Room Key Employee</i>	750	2,400	750	200
<i>Card Room Work Permit</i>	250	NA	250	NA
<i>Third-Party Owner</i> (Individual)	1,000	6,000	1,000	800
<i>Third-Party Owner</i> (Entity)	1,000	11,500	1,000	2,000
<i>Third-Party Owner</i> (Trust)	1,000	2,500	1,000	800
<i>Third-Party Supervisor</i>	750	2,500	750	450
<i>Third-Party Player</i>	500	315	500	NA
<i>Third-Party Other Employee</i>	500	315	500	NA
<i>Third-Party Registrant</i>	500	NA	500	NA
<i>Games Review</i>	500	550	NA	NA

Source: Business and Professions Code; California Code of Regulations, title 4, section 12002 et seq.; California Code of Regulations, title 11, section 2000 et seq..

NA = Not applicable.

However, the current fee structure undercharges license applicants for application fees and background investigation deposits but overcharges card room owners and third-party owners for other nonlicensing regulatory fees. Further, the gap between the revenue from licensing fees and the actual costs of the bureau’s and commission’s licensing activities is growing, as Figure 7 shows. In fiscal year 2017–18, the Gambling Fund received \$4.2 million from application fees and background deposits. In this same year, we estimated that the bureau spent \$9.3 million on licensing personnel and related operating expenditures, while the commission spent \$580,000. This combined total of \$9.9 million in licensing expenditures exceeded fee revenue by \$5.7 million.

**Figure 7**  
**The Bureau’s and Commission’s Licensing Expenditures Have Increasingly Exceeded Licensing Revenue**

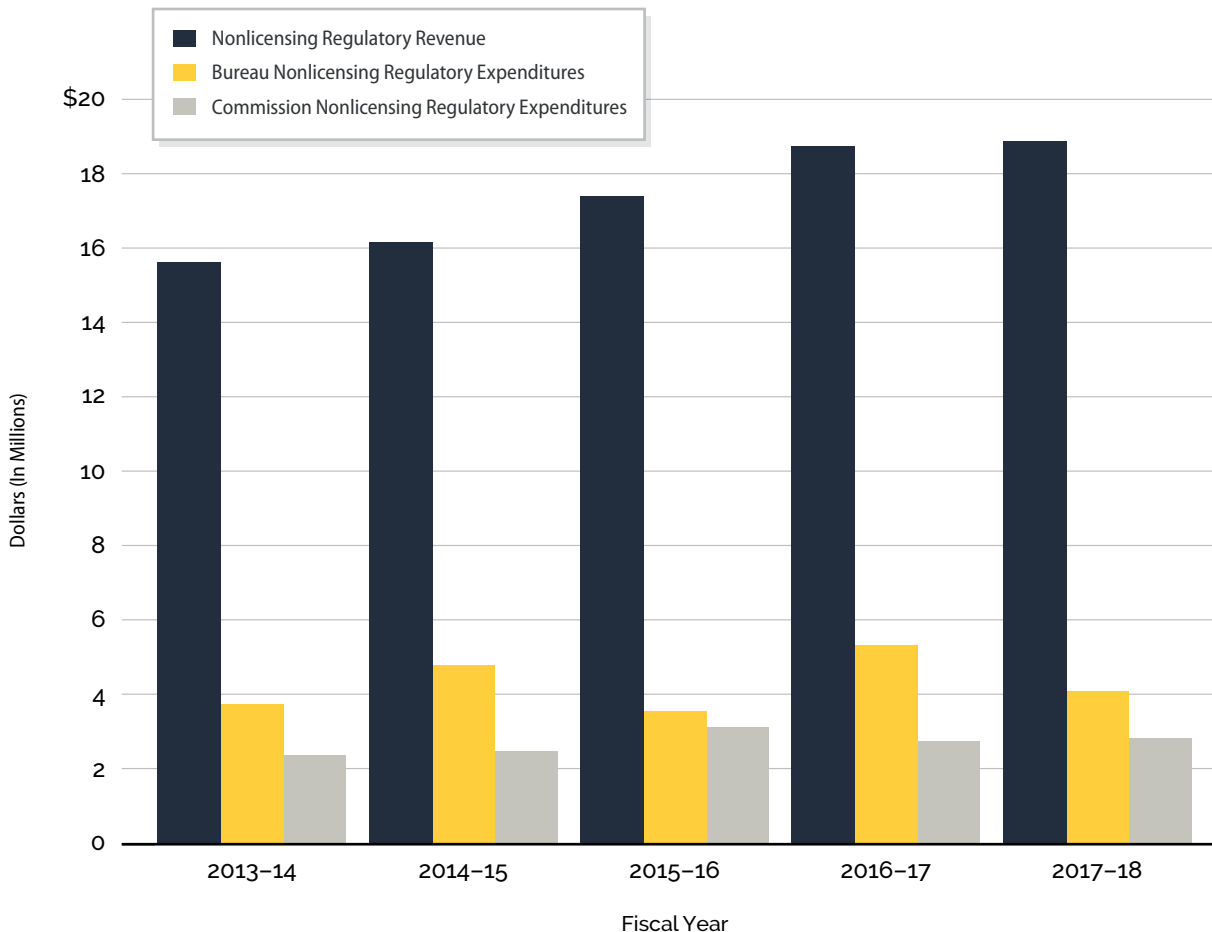


Source: Gambling Fund condition statements, fiscal years 2013–14 through 2017–18; fiscal year 2017–18 commission budget change proposal; fiscal year 2018–19 bureau budget change proposal; and analysis of staffing documentation.

Note: Expenditure amounts are estimates and do not include any licensing costs associated with staff outside of the licensing division in the bureau and commission, such as legal staff.

Even though licensing expenditures have outpaced revenue from license application fees and background deposits, the Gambling Fund’s balance has continued to increase because nonlicensing regulatory fees have generated far more revenue each year than the bureau and commission have spent on the related regulatory activities, as Figure 8 shows. For example, we estimated that the bureau and commission had combined nonlicensing regulatory costs of \$6.9 million in fiscal year 2017–18; however, the nonlicensing regulatory fees generated \$18.9 million in revenue that year—resulting in a surplus of \$12 million in fee revenue. As a result, the nonlicensing regulatory fees that card room owners and third-party owners pay each year have subsidized the bureau’s and commission’s licensing expenditures, indicating that these fee payers are being overcharged. As we discuss in the following section, the current imbalance is so great that it has resulted in a growing Gambling Fund surplus.

**Figure 8**  
**Nonlicensing Regulatory Fees Significantly Overcharge for the Activities They Fund**



Source: Gambling Fund condition statements, fiscal years 2013–14 through 2017–18; fiscal year 2017–18 commission budget change proposal; fiscal year 2018–19 bureau budget change proposal; and analysis of staffing documentation.



The excessive revenue generated from the nonlicensing regulatory fees and the inadequate revenue generated by the licensing fees and background deposits together indicate that the commission and bureau have not aligned fee amounts with their intended purposes. When an agency uses regulatory fees to subsidize different activities because the fee structure for those activities is inadequate, the regulatory fees may be serving as taxes rather than regulatory fees—which is unlawful. Nonetheless, the commission has not updated most of its license application fees since 2008, and it last updated third-party nonlicensing regulatory fees in 2004, based on its estimates at that time of its compliance and enforcement costs. Similarly, the bureau has not evaluated the background deposits it charges since 2011 and could not provide the methodology for how it determined the deposit amounts. Given the lack of alignment that we found between fee revenue and the costs of regulation, we believe that a thorough review of the current fees is urgently needed.

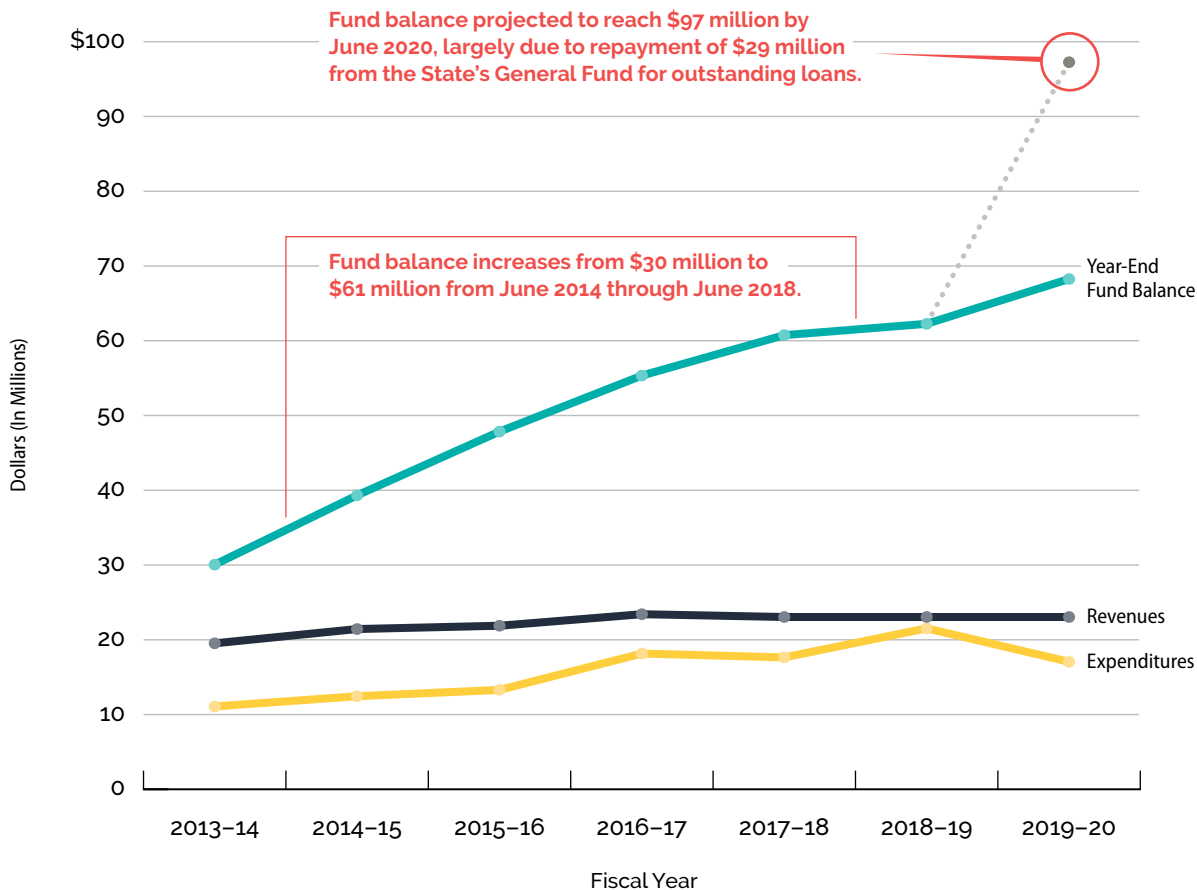
### **The Gambling Fund's Balance Is Excessive and Expected to Increase**

One effect of the lack of alignment between the current fee structure and the costs of oversight is an excessive—and still growing—surplus in the Gambling Fund. Over the last five fiscal years, the balance in the Gambling Fund has doubled. As Figure 9 shows, the ending balance for fiscal year 2013–14 was \$30 million. By the end of fiscal year 2017–18, the balance was \$61 million, more than three times the bureau's and commission's combined total annual expenditures of \$18 million. During this five-year period, the two entities' expenditures averaged only 66 percent of the Gambling Fund's revenue. Additionally, the January 2019 Governor's proposed budget includes the State's General Fund's repayment in fiscal year 2019–20 of \$29 million it received in loans from the Gambling Fund in 2008 and 2011. As a result, the proposed budget projects that the fund balance will increase to more than \$97 million by June 2020—a surplus of more than five times the bureau's and commission's projected annual expenditures.

By comparison, the Government Finance Officers Association (GFOA) recommends that entities maintain fund balances of at least two months of their operating revenue or expenditures, which for the Gambling Fund would be about \$3 million. Although the GFOA acknowledges that particular situations, such as having unpredictable revenue or expenditures, may require a fund balance greater than the two-month minimum, the Gambling Fund's annual revenue has been consistently increasing for years. Further, nothing in the fund's history justifies maintaining a balance that exceeds five years of the bureau's and commission's total monthly expenditures. The bureau and the commission need to take steps to reduce this fund balance to a more reasonable level.

Although a balance equal to two months of expenditures may be insufficient, the fund balance should not exceed one year's worth of expenditures.

**Figure 9**  
The Gambling Fund's Surplus Has Doubled Over the Past Five Fiscal Years



Source: Gambling Fund condition statements for fiscal years 2013-14 through 2017-18 and estimated amounts for fiscal years 2018-19 and 2019-20 from the January 2019 Governor's proposed budget.

### The Bureau's Billing Practices Are Inconsistent and Potentially Unfair to Applicants

One result of the Gambling Fund's excess revenue is that it has allowed the bureau to engage in inconsistent billing practices that are inefficient and potentially unfair to applicants and other fee payers. To track costs against applicants' deposits, bureau licensing staff use a time-reporting system to report the time they spend reviewing license applications, including performing background

investigations, under two categories: billable hours and nonbillable hours. The bureau uses the staff's reported billable hours to calculate the cost of each background investigation and determine whether it must return a portion of the applicant's deposit. Nonbillable hours do not count against the deposit and therefore—because the staff time still represents a cost to the bureau—must be supported by other revenue. The bureau provides descriptions of the activities that staff should report as billable hours and those they should report as nonbillable hours. However, nearly all of the activities and descriptions under billable and nonbillable hours are exactly the same, and the bureau does not have written policies or other formal guidance to assist staff in determining whether hours spent on a case are billable or nonbillable.

According to the licensing director, the proportion of nonbillable hours for a given application should be relatively small. She asserted that staff discuss allocation of hours with their managers, who determine on a case-by-case basis whether work is billable or nonbillable. The licensing director told us that as a general practice, staff report nonbillable hours for time they do not feel that the applicants should pay for, such as the hours staff spend refamiliarizing themselves with applications or completing the final steps in reviews when they have expended the entire deposit.

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**Staff often reported considerable amounts of nonbillable time when performing background investigations.**

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However, likely as a result of the bureau's weak guidance, our review of time-reporting documents found that staff reported their time in a manner inconsistent with the licensing director's expectation. Specifically, staff often reported considerable amounts of nonbillable time when performing background investigations. For 28 of the 40 license applications we reviewed—which went as far back as 2008 but which the bureau mostly completed since 2016—staff reported that at least 25 percent of the time they spent on background investigations was nonbillable. For 19 of the applications, the number of nonbillable hours equaled or exceeded the number of billable hours. For 15 applications, nonbillable hours made up 75 percent or more of total hours. As Table 4 shows, the nonbillable hours for these applications represented costs to the bureau of \$198,000, compared to \$110,000 in billable hours covered by application deposits. In one extreme situation, staff reported 629 nonbillable hours for the review of an application, with a cost of more than \$47,000.

Its staff's use of nonbillable time represents a significant expense for the bureau. To determine the extent of the issue, we reviewed a bureau report that listed all hours that licensing staff reported during fiscal year 2017–18. The report showed that staff responsible for processing card room-related applications reported more than 38,000 nonbillable hours—more than three times the total 11,000 billable hours they reported. At the bureau's billing rate of \$76 per hour, these nonbillable hours represented \$2.9 million in licensing costs not covered by applicants' deposits for fiscal year 2017–18 alone. When we asked the bureau about the results of our review, the licensing director described additional examples of time that staff would report as nonbillable, such as when they prepare documents for evidentiary hearings or take over applications from another analyst, requiring them to familiarize themselves with the applications. However, apart from providing these types of examples, the bureau offered no justification for why staff reported fewer billable hours than they should have. In fact, the bureau's written guidance to its licensing staff directs them to "be productive and strive to bill a minimum of six hours, when appropriate, each day as we are a reimbursable agency."

**Table 4**  
The Bureau Billed Many Applicants for Only a Fraction of Its Actual Background Investigation Costs

	BILLED	UNBILLED
<i>Total hours charged</i>	1,443	2,612
<i>Percent of total</i>	36%	64%
<i>Highest number of hours charged for single case</i>	223	629
<i>Total cost for all cases</i>	\$110,000	\$198,000

Source: Analysis of the bureau's billing reports for 40 applications.

The fact that staff have not followed the bureau's guidance—and managers have not enforced it, despite the requirement that they must approve the manner in which staff report their time—points to fundamental gaps in the bureau's oversight of its employees. Further, it helps explain why licensing revenue from applicants is significantly lower than the bureau's actual costs to review applications. As we discuss previously, total licensing expenditures were nearly \$5.7 million more than licensing revenue in fiscal year 2017–18, and the bureau's expenditures account for \$5.1 million of this difference. The bureau would be unable to sustain its practice of reporting so few billable hours if the revenue

from nonlicensing regulatory fees that card room and third-party company owners pay was not significantly higher than it should be and thus subsidizing the bureau's inefficiencies.

As we describe above, state law allows the bureau to request additional funds from an applicant if an investigation costs more than the initial deposit it collected. In theory, the ability to request additional funds should allow the bureau to fully recover its investigation costs and to avoid accruing large amounts of nonbillable time. However, we determined that the bureau was inconsistent in requesting additional funds from applicants. Bureau staff regularly spent all initial billable hours, then proceeded to report nonbillable hours until completing an application; in fact, the bureau asked only five of the 40 applicants we reviewed for additional funds, and all five were third-party owner applicants. For the other applications, staff continued their work by reporting nonbillable hours, enabling them to avoid having to justify the need to request additional funds from the applicants. If the large proportion of hours staff have reported as nonbillable reflect duplicated or otherwise unproductive work, then this nonbillable time has likely contributed to the bureau's persistent licensing backlog.

The lack of formal policies or any other clear guidance detailing the circumstances under which the bureau will request additional funds from applicants also raises questions of fairness. For example, we reviewed two applications the bureau received for the same type of license. It charged these applicants for nearly the same number of billable hours—31.25 and 31 hours—with costs of \$2,375 and \$2,356, respectively. However, the first application required the bureau to perform 96.5 nonbillable hours of work, representing a cost of \$7,334, while the second application included only 4.5 nonbillable hours, equivalent to just \$342. In this instance, staff performed significant work for the first application for which that applicant did not pay; instead, this work was in effect heavily subsidized by card room owners' and third-party company owners' nonlicensing fees. In the absence of formal policies for handling nonbillable time and a system that ensures staff comply with those policies, the licensing costs the bureau ultimately charges to individual applicants can appear arbitrary and unfair.

### **The Bureau's Licensing Staff Reported Spending Nearly Half Their Time on Activities Other Than Application Review**

Our review of the bureau's time-reporting documentation raised additional concerns about efficiency within the licensing division. Under the bureau's time-reporting system, staff can report time under a third category, known as *noncase* time. The bureau's list of time-tracking activities describes activities for which

staff are to report noncase hours. The list is consistent with the licensing director's explanation that staff should charge noncase hours for activities such as filing and for time that is unrelated to background investigations, such as attending training. The licensing director confirmed that it would be reasonable to expect staff to report occasional hours for these activities. However, as Figure 10 demonstrates, the bureau's records show that licensing staff reported nearly half of their time—45,700 hours—as noncase hours in fiscal year 2017–18.

**Figure 10****Bureau Licensing Staff Spend Only a Fraction of Their Time Performing Billable Activities****Billable Time**

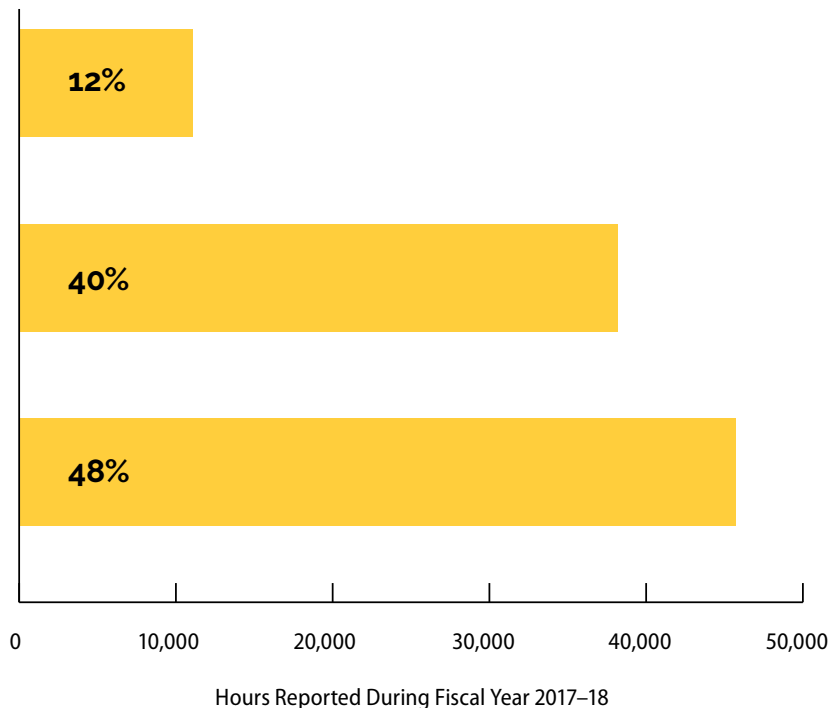
Should be used to charge at least six case-related hours per day, when appropriate, against the applicant's background deposit.

**Nonbillable Time**

Should be used for case-related hours not charged against the applicant's deposit because staff do not feel the applicant should pay for the work in question, such as time staff spent familiarizing with cases.

**Noncase Time**

Should be used for case-related time totaling less than 15 minutes, or for up to one hour of personal time per day for noncase tasks, such as checking voicemails.



Source: Analysis of bureau timekeeping records for fiscal year 2017–18 and discussions with the bureau manager.

Note 1: At the bureau's rate of \$76 per hour, billable time amounts to \$841,000, nonbillable time to \$2.9 million, and noncase time to \$3.5 million.

Note 2: The bureau's written descriptions for nearly all activities it identifies under billable and nonbillable hours are exactly the same, which is why we obtained the above descriptions from discussions with the bureau's manager.

When we asked about the staff's high proportion of noncase time, the licensing director explained that staff also use noncase hours to account for work on application-related tasks that take less than 15 minutes to complete. She stated that the bureau is not able to quantify this time because doing so would require it to look through the notes in the system; further, she did not think that staff

included the names of every case on which they worked for less than 15 minutes. However, we do not understand how these activities could account for such a considerable amount of total time unless staff were constantly rotating among applications. Considering the persistent backlog of applications, we are concerned that staff have reported so much of their time on activities unrelated to reviewing applications and conducting background investigations.

The licensing director added that licensing staff are allowed one hour of personal time per day for noncase tasks, such as checking voicemails, reviewing emails, entering their time into the time-reporting system, and taking breaks. She stated that an hour per day per employee accounts for 12,000 hours per year. Even allowing for this personal time, however, our review found that bureau staff still reported spending more than a third of their total time on activities not directly related to reviewing applications or to performing background investigations.

Because many applicants have been waiting years for licenses and the State has considerably increased the number of bureau licensing staff to address the backlog, the bureau must take steps to ensure that its staff spend as much time as possible reviewing applications and that they correctly report this time. Its current approach provides no such assurance. Until the bureau establishes clear protocols for how staff are to spend and report their time and ensures that managers enforce those protocols, it will be unable to demonstrate that increases in staffing or licensing fees are necessary and justified.

## **Recommendations**

### ***Legislature***

To ensure that all fees that generate revenue for the Gambling Fund have clear, stated purposes limiting their use, the Legislature should require that when updating fee amounts, the commission and the bureau must also update their regulations to include clear statements about the need for and appropriate use of each fee type.

### ***Bureau***

To ensure that it fairly charges applicants for the cost of its licensing activities, the bureau should establish and implement policies by July 2019 requiring staff to properly and equitably report and bill time and restricting which activities staff may charge to nonbillable and noncase hours. It should also establish clear thresholds for the

proportions of time staff may charge to the various categories and require the bureau's management to review compliance with the pertinent restrictions.

### ***Bureau and Commission***

To better align the revenue in the Gambling Fund with the costs of the activities that the fund supports, the bureau and the commission should conduct cost analyses of those activities by July 2020. At a minimum, these cost analyses should include the following:

- The entities' personnel costs, operating costs, and any program overhead costs.
- Updated time estimates for their core and support activities, such as background investigations.
- The cost of their enforcement activities.

Using this information, the bureau and commission should reset their regulatory fees to reflect their actual costs. Before conducting its fee study, the bureau should implement our recommendations to improve its processes for assigning applications, ensuring the completeness of applications, and developing time-reporting protocols.



## The Bureau's and Commission's Inconsistent Regulations and Practices Have Resulted in the Unequal Treatment of Applicants

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### Key Points

- Inconsistencies in the commission's regulations create wide-ranging differences in how it treats applicants. These differences include significant variations in the time frames in which applicants must submit their applications for review, in the extent to which applicants can reapply for licenses, and in the ability of applicants to work in the gaming industry while their applications are pending.
- The bureau has applied different levels of scrutiny to applicants without clear justification, often as the result of staff's inconsistently following bureau procedures or as a result of issues with the procedures themselves. The bureau's incomplete documentation prevented us from more fully assessing the consistency of its reviews of aspects of applicants' backgrounds.
- The commission does not have a clear, formal process for allowing applicants that it has referred to evidentiary hearings to opt out of those hearings. As a result, it may harm some applicants by unnecessarily including negative information about those applicants in the decisions it publishes.

### The Commission Has Established Regulations That Result in the Inconsistent Treatment of Applicants

The commission is responsible for developing state regulations that govern most aspects of the licensing application and review process. However, the regulations it has established include inconsistencies across the different license types. These inconsistencies create unjustified differences in how applicants experience the licensing process and may also expose the public to risk. Table 5 summarizes some key differences in the commission's regulations for specific license types.

Several important differences exist in the way that regulations treat third-party applicants in comparison to other types of applicants. For example, as Table 5 demonstrates, license applicants from card rooms—such as owners, key employees, and employees requiring work permits—must submit full applications to be able to work during the time the bureau is reviewing their applications. In contrast, third-party applicants first apply for status as registrants—a temporary status for third-party applicants only—and do not submit applications for licensure until the bureau requests that they do so. The commission's regulations do not establish time frames in which the bureau must request registrants to apply for licensure, and our review found that it has waited years before making such requests.

**Table 5**  
Commission Regulations Treat Applicants Differently Depending on Their License Types

	CARD ROOM			THIRD-PARTY		
	WORK PERMITEES	KEY EMPLOYEES	OWNERS	PLAYERS	SUPERVISORS	OWNERS
<i>Applicant must submit full application to work</i>	Yes	Yes	Yes	No	No	No
<i>Bureau must notify whether application is complete</i>	No	Yes	Yes	Yes	Yes	Yes
<i>Time frame(s) exist for commission to issue a decision on an initial license</i>	No	Yes	Yes	Yes	Yes	Yes
<i>Applicant retains temporary license upon bureau recommendation to deny initial license</i>	No	No	NA	Yes*	Yes*	Yes*
<i>Applicant is eligible for license if previously denied</i>	Yes	Yes	Yes	No	No	No

Source: California Code of Regulations, title 4, section 12002, et seq.; and bureau documentation.

NA = Not applicable. Regulations do not discuss the circumstances under which a card room owner retains or loses a temporary license.

\* If the bureau recommends the denial of an initial license, regulations require the cancellation of the applicant's card room temporary license. However, under similar circumstances, a third-party applicant retains his or her temporary status pending a noticed hearing and determination to cancel by the commission.

In considering whether to grant registrant status, the bureau reviews an applicant's criminal history to identify any disqualifying criminal convictions. However, the bureau does not consider—nor does it require the applicant to provide—any of the other elements of a full background investigation, such as the applicant's previous employment or financial history. As a result, all the third-party applicants we reviewed who ultimately submitted full applications were allowed to work for some time in card rooms with only minimal background investigations. One third-party owner ran a gaming business for more than two and a half years before the bureau requested that he submit a full application. Notably, that investigation resulted in the bureau recommending the denial of the application in part because the applicant failed to disclose full and true information, and the commission ultimately concurred. Allowing individuals to work in the industry for long periods before even submitting full license applications may create risks for the public in instances when the applicants are ultimately deemed dishonest or otherwise unsuitable for licenses.

The registrant process also leads to the disparate treatment of applicants in other ways. Although card room applicants lose their temporary working status when the bureau recommends denial to the commission, third-party applicants maintain their ability to work until the commission actually denies their license applications because regulations require the commission to hold a hearing to

cancel a third-party registration. As a result, third-party applicants can continue to work in the industry even if the bureau determines they are unsuitable for licenses. In one case we reviewed, a third-party applicant was convicted of a disqualifying criminal offense during his time as a registrant but was allowed to continue working until the commission eventually held a hearing two years and eight months later. When we reviewed eight applications that the commission ultimately denied, we found that the third-party registrants worked with temporary status more than twice as long, on average, as the card room employees.

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**Third-party applicants can continue to work in the industry even if the bureau determines they are unsuitable for licenses.**

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Other differences in the regulations affect applicants' experiences both during and after the application process. For example, regulations require the bureau to notify most applicants within specific time frames whether their applications are complete. However, as the second row of Table 5 shows, no such requirement exists for applicants seeking card room work permits. Work permit applications are also not subject to the commission's decision time frames, as the third row of the Table demonstrates. Further, the regulations are inconsistent about denied applicants' eligibility for licenses in the future. As the bottom row of the Table shows, applicants whose licenses the commission denies are permanently ineligible for third-party licenses; in contrast, the regulations do not restrict denied applicants' ability to later apply for card room licenses.

These inconsistent standards foster the unequal treatment of people working in or applying to work in the gaming industry, and they do so without sufficient justification. When we asked why the regulations treat third-party applications differently from other types of applications, the commission's executive director explained that she was not working for the commission at the time it developed the regulations. However, she speculated that the commission might have taken the approach it did because it began regulating the third-party industry after it was already in existence. According to the executive director, the commission may have allowed third-party owners and employees to continue in the gaming industry with minimal background reviews to avoid significant disruptions to the gaming industry while it began licensing this large group of individuals. However, given that the regulations have now been in place for more than a decade, this

rationale for treating third-party owners and employees differently from card room applicants is no longer valid. Other inconsistencies, such as those excluding work permit applications from time frame and notification requirements, have no apparent justification.

The commission's executive director told us that the commission has been working for a couple years to update its regulations to make them more consistent across license types. She estimated that it would take roughly another year before the commission would be prepared to submit the updated regulations to the Office of Administrative Law to begin the public review process. As the commission moves forward, it must consider both fairness to applicants and the public's interest in ensuring that individuals working in the gaming industry are vetted in a timely, appropriate manner.

### **The Bureau's Procedures and Practices Lead to Inconsistencies in Background Investigations and the Documents Retained to Support Them**

Given the broad discretion the bureau has in processing license applications and determining applicants' suitability for licenses, it is important that it has procedures for conducting background investigations that demonstrate that it treats all applicants and licensees fairly and consistently. It is also critical that staff follow those procedures. We reviewed 18 application files to determine the extent to which the bureau has such procedures and follows them. Although we found that the bureau adequately supported all of its licensing recommendations to the commission, we also identified instances when the bureau treated applicants inconsistently and unequally during background investigations without justification. Further, this inconsistent and unequal treatment affected the content of the reports the bureau issued to the commission with its licensing recommendations. The types of inconsistencies we identified included differences in the procedures the bureau performed, the questions it asked, and the information it included in its recommendation reports to the commission for some applicants.

The bureau's procedures for conducting background investigations subject applicants to different levels of scrutiny without clear justification. The bureau's licensing division has separate units for processing each license type, and each unit has its own procedures for completing its background investigations. We expected that the bureau would subject applications for some types of licenses, such as card room owners, to more thorough levels of review than others, such as work permits, because of the positions' higher levels of responsibility. However, we also expected that most units would share the same basic procedures. Nonetheless, as Table 6 shows, the

bureau’s background investigation procedures vary considerably for different types of licenses and do not always reflect the associated level of responsibility.

For example, the background investigation procedures for all license types except card room owners require staff to note in its reports to the commission when an applicant has failed to appear in court when required to do so. Similarly, the background investigation procedures for most license types include specific directions to submit inquiries to the International Criminal Police Organization, the National Law Enforcement Telecommunications System, and other databases. However, the procedures do not require all such inquiries for card room owners and third-party players. The bureau acknowledged some of the discrepancies we observed and provided additional documentation in response to others. However, that documentation did not address the inconsistencies in the procedures that Table 6 lists.

**Table 6**  
The Bureau’s Procedures Inconsistently Require Background Investigation Steps

STEP IN BACKGROUND INVESTIGATION PROCESS	LICENSE TYPE					
	CARD ROOM			THIRD-PARTY		
	LEVEL OF RESPONSIBILITY					
	LOW WORK PERMITEES	MEDIUM KEY EMPLOYEES	HIGH OWNERS	LOW PLAYERS	MEDIUM SUPERVISORS	HIGH OWNERS
<i>Check absent-parent report</i>	✓	✓	X	X	✓	✓
<i>Request police reports for arrests subsequent to filing an application</i>	✓	✓	X	X	X	X
<i>Submit all applicable database inquiries*</i>	✓	✓	X	X	✓	✓
<i>Review disclosure of military history</i>	X	✓	✓	✓	✓	✓
<i>Include failures to appear in court in the report to the commission</i>	✓	✓	X	✓	✓	✓
<i>Include unresolved failure to pay fines in report to the commission</i>	✓	✓	X	✓	✓	✓
<i>Include real property holdings in the report to the commission</i>	NA	NA	X	NA	NA	✓

Source: Bureau background investigation procedures.

✓ = Included in procedures.

X = Not included in procedures.

NA = Not applicable to application type.

\* Examples of databases include the Department of Motor Vehicles, the International Criminal Police Organization, the National Law Enforcement Telecommunications System, and the Association of Law Enforcement Intelligence Units Gaming Index.

Perhaps in part because of these inconsistent procedures, we also identified inconsistencies in the questions that staff asked applicants and the information that the bureau included in its recommendation reports to the commission. For example, the bureau's procedures for investigating third-party supervisor applicants instruct staff to obtain statements from applicants who have suspended driver's licenses describing how they get to and from work. However, the bureau's procedures for investigating third-party player applicants do not include an equivalent instruction. In one of the 18 applications we reviewed, the bureau recommended denial of a third-party player license solely because the applicant admitted to driving with a suspended license at the time she filed her application; the commission ultimately denied that application because the applicant did not attend her hearing and did not provide evidence in favor of granting a license. Because the bureau uses driving with a suspended license as a reason to recommend denial of a license application, we would expect all of the bureau's investigation procedures to include this question to ensure that it treats applicants fairly and consistently.

An inconsistency in the bureau's procedures also resulted in it including negative information in reports for two of the 18 applications we reviewed while not including similar negative information in its report for a third application. Consistent with its procedures, one of the bureau's licensing units cited as a concern that the first two applicants failed to file for their permanent key employee licenses within 30 days of receiving their temporary permits, as state regulations require. However, another licensing unit did not admonish the third applicant for working in a card room for nearly three years before submitting his application for a work permit or for working in a card room while younger than the legal minimum age of 21.

When we asked about the inconsistent handling of these cases, the licensing director acknowledged that staff should have asked questions about the third applicant's age and work history during the background investigation. However, the bureau's procedures for that license type do not require staff to ask those questions. Because they did not do so, the bureau's report to the commission makes no reference to issues that were more serious than those raised during the review of the other two applications. The commission approved the third applicant's license as the report recommended approval with no concerns cited. Although the commission approved the license of one of the other two applicants, it did not approve the other. In this last case, the bureau cited the late filing of the application among its reasons for recommending denial.

Similarly, we noted an instance in which the bureau asked one third-party owner applicant about real property purchases subsequent to his application but did not ask the same questions of

another third-party owner applicant.<sup>6</sup> When the bureau asked the first applicant about purchases he made subsequent to filing his application, the applicant did not disclose a purchase, and the bureau used his response as one of several reasons to deny his license. The bureau also became aware of the second applicant's real property purchases subsequent to his filing his application through a review of his financial statements, but it did not ask the second applicant whether he made those purchases—as it did with the first applicant. As a result, unlike with the first applicant, the bureau did not put the second applicant in a position in which he might fail to disclose information. By failing to ensure that it followed similar steps in its background investigations with respect to the questions it asked, the bureau risked subjecting the applicants to different levels of scrutiny and producing different—and possibly unjustified—outcomes.

In addition, we identified a report to the commission that included information that the bureau had requested from the applicant but that the applicant was not required to disclose. Specifically, the report included the applicant's two bankruptcies that were more than 10 years old, even though the bureau's procedures for this license type instruct staff to only report on bankruptcy filings within the past 10 years. Although the licensing director stated that the bureau includes bankruptcies older than 10 years when applicants have had more than one bankruptcy, this explanation is inconsistent with the written procedures.

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**By failing to ensure its procedures subject applicants to equal treatment, the bureau risks subjecting some applicants to greater scrutiny than others.**

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By failing to ensure that its procedures subject applicants to equal treatment and that staff consistently follow those procedures, the bureau risks subjecting some applicants to greater scrutiny than others without justification. The bureau's recommendations carry significant weight, as the commission often concurs with the bureau when making licensing decisions that may result in denial and may bar individuals from reapplying in the future. Consequently, it is crucial that the bureau take all steps necessary to demonstrate that it treats all applicants consistently and fairly.

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<sup>6</sup> The bureau reviews real property purchases as a part of its financial review of third-party owner applications. The bureau's procedures for conducting background investigations of owners are the most financially focused of its procedures for third-party applicants because owners possess the greatest level of responsibility of these license types.

In addition, the bureau's inconsistent handling of records limits its ability—and ours—to determine the extent to which it has performed background investigations in accordance with its policies. We performed a detailed review of 11 of the 18 application files to determine whether the bureau had consistently performed a selection of background investigation procedures. However, six of these 11 files were missing documentation showing that investigators completed one or more required steps. For example, one application file did not contain tax returns documenting the bureau's required review of the applicant's financial history. Another file lacked a required DMV report to demonstrate that staff comprehensively reviewed the applicant's driving history. We also reviewed a renewal application that contained a checklist on which bureau staff indicated that they requested and reviewed various database reports to ensure that the applicant had incurred no new infractions since her last approval. However, because the file did not contain any of the database reports, we were unable to verify that this review took place.

When we asked about missing documentation, staff provided a list that showed that the bureau is supposed to retain only some of the documentation that staff collect and review when conducting background investigations. However, we found that staff have inconsistently followed that policy, with different staff retaining varying levels of documentation for completed cases. When we asked about the rationale for not retaining certain documentation, the licensing director said that a lack of available space in the file room might have been an issue at one time but that she was unable to determine why the bureau adopted its current approach of purging certain documentation after completing its review. Not retaining key documentation and the inconsistent manner in which staff do retain records negatively affect the bureau's ability to demonstrate that it has applied its background investigation process consistently across applicants. Therefore, we believe the bureau should reevaluate the documentation it retains and its rationale for doing so. The licensing director stated that the bureau intends to conduct such a reevaluation in the near future.

### **The Commission's Lack of Policies for Allowing Applicants to Opt Out of Hearings May Cause Unnecessary Harm**

The commission does not have a clear, formal process for allowing applicants that it has referred to evidentiary hearings to opt out of those hearings. As a result, when it denies certain applications, the commission publishes decisions that may harm some applicants by unnecessarily providing criminal background information. As we previously discuss, the commission either approves applications at its regular meetings—as happens for the majority of applicants—or refers the applications to evidentiary hearings for further review.



The current regulations require the commission to hold evidentiary hearings when denying applications and to publish its decisions either approving or denying applications within 75 days of the conclusions of hearings. In its written decisions, the commission includes the details of each side's arguments as support for its approval or denial. The commission held 34 of these hearings in 2018.

As we discuss earlier, the commission referred seven of the 18 applications we reviewed to evidentiary hearings, and in four instances, the applicants elected not to attend their hearings. After deciding to hold a hearing, the commission sends a form asking the applicant to formally request or waive the right to a hearing. The form explains that the waiver of an evidentiary hearing may result in the commission making a default decision based on the bureau's recommendation report, as well as any supplemental reports or other documentation that the bureau provides. The form also states that the hearing may occur as scheduled, even if the applicant does not request a hearing.

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**The amount of negative information the commission included in its written decisions varied among applicants who did not attend their evidentiary hearings.**

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We found that the amount of negative information the commission included in its written decisions varied among applicants who did not attend their evidentiary hearings. Two of the applicants returned the forms requesting hearings but later informed the commission that they no longer wanted to attend. Although these applicants informed the commission at least two weeks in advance, the commission held the evidentiary hearings in both cases and, in doing so, asked the IGLS attorney to present the bureau's evidence against the applicants. The commission denied these two applications, and its written decisions cited the basis of the denials as the applicants' failure to attend the hearings or provide any evidence in favor of granting the applications. However, the written decisions also included the criminal background information about the two applicants that IGLS had presented at the hearing. Although the commission did not rely on the criminal background information in its reasons for denying the applications, the commission included it in the written decisions as a result of the hearings taking place. Therefore, holding evidentiary hearings when applicants do not participate may cause harm by leading to the unnecessary publication of negative information.

We found the outcomes for the remaining two cases more reasonable. Specifically, the commission's written decision for the third applicant who did not attend his hearing included significant detail. However, the commission denied this applicant because of a disqualifying criminal offense, and in such instances, the commission may need to include details about an applicant's background in its written decision to show the basis for that decision. The fourth applicant did not return the form and the commission elected not to hold an evidentiary hearing. In its written decision, the commission cited the applicant's failure to attend the default hearing—which took place at a regular commission meeting—or provide any evidence in favor of granting the application as causes for denial. This is the same reasoning it used for the two cases discussed above. However, the commission did not include any details from the bureau's background investigation in the decision. This approach is more efficient than holding an evidentiary hearing when the applicant does not want one, and it protects applicants from unnecessary disclosures of any negative findings from background investigations.

The varying degree of detail in the commission's written decisions for these four applicants creates concerns about applicants' ability to withdraw from the hearing process, particularly in light of the public nature of the commission's decisions. The commission posts its decisions on its website, where the content could negatively affect the applicants' future employment and other opportunities. The commission's chief counsel confirmed that the level of detail the commission includes depends in part on whether the commission has held an evidentiary hearing or not.

When we asked why the commission holds evidentiary hearings after applicants inform it—even in writing—that they will not be attending, the chief counsel explained that to cancel scheduled evidentiary hearings, the commission requires the applicants to explicitly waive their rights to that hearing. However, we noted that the regulations allow the commission to hold hearings even in cases when applicants have formally waived their rights. Further, the commission has not established any formal procedures to guide staff on how to handle instances when applicants opt out of the hearing process before the hearings occur, nor for providing explicit instructions to applicants on how to opt out. Given that holding unnecessary hearings is inefficient, may pose harm to applicants, and may raise questions of fairness, we believe that the commission should ensure that all applicants are given ample opportunity to forgo evidentiary hearings if they desire to do so and that it should cancel the hearings if applicants chose not to attend.

After we shared our concerns with the commission, its executive director informed us that it is taking steps to provide specific direction to applicants about their ability to withdraw from the

process, as well as to develop internal procedures for handling instances in which applicants waive their hearing rights. However, in order for the commission to take such actions without being in conflict with state law, the Legislature will need to amend the law to allow the commission more flexibility when denying applicants, a recommendation we make in the first section of this report.

## **Recommendations**

### ***Bureau***

To ensure that its level of review is commensurate to license type, the bureau should review and revise each of its background investigation procedures as needed by November 2019.

To ensure that it treats applicants consistently, the bureau should begin conducting periodic reviews by November 2019 to determine whether staff are following procedures when conducting background investigations for applicants for all license types.

To ensure that it has the ability to justify the results of its background investigations, the bureau should develop a formal record retention policy for application documentation by November 2019. This policy should include rationales for retaining types of documents and should establish a process for ensuring staff compliance.

### ***Commission***

To increase uniformity in the licensing process, the commission should revise its current regulations and submit them to the Office of Administrative Law for public review by May 2020 to address the following areas of inconsistency:

- Application processes and time frames.
- The ability to work during the application process.
- The ability to reapply after denial.

In revising its regulations, the commission should increase consistency across application types while minimizing risk to the public.

To ensure that it does not hold hearings that may cause applicants unnecessary harm, the commission should, following the Legislature's amendment to state law that we previously recommend, establish and implement formal protocols for informing applicants how to withdraw their requests for hearings and for guiding commission staff when discontinuing the hearing process at the request of applicants.

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## OTHER AREAS WE REVIEWED

To address the audit objectives approved by the Audit Committee, we reviewed the subject areas in Table 7. These areas include the bureau's compliance section's time reporting and expenditures and the commission's compliance with open meeting laws and other legal issues. The Table indicates the results of our review and presents any associated recommendations that we have not already discussed in the other sections of this report.

**Table 7**  
Other Areas Reviewed as Part of This Audit

### The Bureau's Failure to Ensure Its Employees Allocate Their Enforcement Activities to the Appropriate Funding Sources Has Contributed to the Gambling Fund's Surplus

In addition to the current fee structure, another factor has inappropriately contributed to the Gambling Fund surplus. Specifically, the bureau has not ensured that employees in its enforcement section align their activities with the funding sources for their positions. When reviewing the enforcement section's time-reporting data, we identified many instances in which employees in positions funded by the Special Distribution Fund—which supports the regulation of tribal casinos—reported performing card room-related activities. Although we also noticed instances when employees funded by the Gambling Fund reported performing tribal casino enforcement activities, the overall effect was greater on the Special Distribution Fund, which funded more than 27,000 hours of card room-related enforcement work over the last three fiscal years. According to the assistant director who heads the compliance unit, the bureau is aware that its employees are not charging their time in accordance with their positions' funding sources, and it is currently taking steps to address this problem. With the exception of two quarters in fiscal year 2018–19, the bureau has not taken steps to reconcile and reimburse the funds to date.

#### **Recommendations**

- *To ensure that it compensates the Special Distribution Fund for the card room-related enforcement activities for which that fund has paid, the bureau should reconcile the hours due to the Special Distribution Fund for at least the last three fiscal years by November 2019. Moving forward, the bureau should ensure that it provides prompt reimbursement when employees in positions that are funded by one source perform activities that should have been funded by another source.*
- *To ensure that its employees allocate their activities to the correct funding sources, the bureau should by July 2019 formalize policies and procedures that provide clear guidelines to employees when reporting time spent on activities that relate to funding sources other than the funding sources for their positions.*

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### The Bureau Closely Monitors Enforcement Agents' Funds But Could Better Track Where These Employees Spend Their Time

- Justice's law enforcement policy requires monthly audits to track amounts that enforcement agents spend in the field, and the bureau's auditors perform these audits consistently. The bureau allots \$5,000 to \$10,000 per month for agents in each of its two regional offices to use during their investigations. Our review of expenditures from the past three years found that each regional office generally spent considerably less than the allotted amounts and that the expenditures were consistent with Justice policy. We observed that the agents primarily used the funds for gambling while working undercover. The offices also used the funds to store, purchase, access and transport evidence; to pay informants; to purchase undercover phones; and to obtain online gambling profiles. Our testing found that the reported expenses were consistent with bureau policy and that supervisors reviewed expenditures in line with that policy.
- The audit objectives directed us to determine how much time the bureau's employees—including special agents—spend in each card room and casino when testing those establishments' compliance with state laws and regulations. However, the bureau's current approach to tracking its enforcement employees' hours prevented us from being able to analyze their time at this level of detail. Staff confirmed that the bureau's time-reporting system does not track the specific card rooms in which its employees work. The bureau has the ability to transfer some but not all of this information into the time-reporting system from a separate database that tracks specific criminal investigations, and in some cases, this information may identify a card room by name. However, even when the bureau had transferred information from the database to the time-reporting system, we found that in many cases the data were not sufficiently detailed to identify the card rooms in which employees worked.

#### **Recommendation**

*To ensure that it can provide useful and accurate data on the locations where enforcement employees spend their time, the bureau should equip its time-reporting system by November 2019 with the capacity to track all hours employees spend at each card room and casino.*

### The Commission Generally Complies With Open Meeting Laws

- Our review indicates that the commission has substantially complied with key requirements of the Bagley-Keene Open Meeting Act. We identified minor issues in its open meeting notices, such as incomplete contact information, as well as minor procedural discrepancies related to publicly reconvening after closed meetings. However, these issues do not pose serious threats to the transparency of the commission's proceedings. We brought these issues to the commission's attention, and it is taking steps to resolve them.
- We did not find any evidence of activities that would pose conflicts of interest for commission attorneys during the meetings and hearings we reviewed.

### We Did Not Identify Legal Due Process Concerns

State and federal law guarantee both substantive and procedural due process. Substantive due process protects against arbitrary government action. It prevents government from taking action that is arbitrary, discriminatory, or lacks a reasonable relation to a proper legislative purpose. The threshold for demonstrating a violation of substantive due process is extremely high. Governmental action constituting abuse must "shock the conscience." Such behavior can include that which is outrageous, egregious, truly irrational, intended to injure in some unjustifiable way, or conducted with deliberate disregard of the state's fundamental processes. Substantive due process concerns could conceivably apply to both the commission's hearing procedures and the bureau's investigative procedures. Procedural due process ensures a fair adjudicatory process before a person is deprived of life, liberty, or property. An adjudicative process that meets due process standards must, at minimum, provide reasonable notice and an opportunity to be heard.

We reviewed the hearing and investigation procedures set forth in the Gambling Control Act and related regulations. These statutes and regulations govern the substantive grounds for granting or denying a gambling-related license or work permit, and prescribe the commission's procedures for hearings and general meetings on applications. For example, title 4, section 12060 of the regulations governs the Commission's process for holding evidentiary hearings, including providing notice to the applicant in advance of a scheduled hearing. Applying the same principle and high threshold described above, our review of the relevant statutes and regulations did not identify a policy or procedure that would, by itself, serve as a basis for a due process violation.

**The Same Attorney Representing Both the Bureau and the Commission Does Not Pose a Conflict of Interest or Violate the Law**

The audit objectives directed us to assess whether the same attorney representing both the bureau and commission is a conflict of interest or violates the Judicial Code of Ethics or the Administrative Procedures Act (APA). The APA applies the Judicial Code of Ethics to the commission and presiding officers at commission hearings, not to attorneys appearing before the commission or representing the bureau or commission. In addition, a conflict-of-interest concern surrounding an attorney who represents multiple parties arises when the attorney obtains confidential information from one client that the attorney then uses against the client on behalf of another client. Guided by these principles, we did not find evidence of a conflict of interest in the practice of an attorney representing the bureau during a commission hearing and subsequently representing the commission upon an applicant's appeal of the commission's decision.

We conducted this audit under the authority vested in the California State Auditor by Government Code 8543 et seq. and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
California State Auditor

Date: May 16, 2019

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## APPENDIX

### Scope and Methodology

The Audit Committee directed the California State Auditor to perform an audit related to the bureau's and commission's policies and procedures, the Gambling Fund balance, and several other audit objectives. The table below outlines the Audit Committee's objectives and our methods for addressing them.

### Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed relevant laws, policies and procedures, industry standards, and best practices.
2 Review the bureau's process for reviewing the backgrounds of gaming establishments and other licensees and determine whether it is performing these reviews in an efficient and effective manner and in accordance with the APA.	<ul style="list-style-type: none"> <li>Reviewed bureau policies and procedures related to performing background investigations, including any implications for the APA.</li> <li>Analyzed the efficiency and effectiveness of the bureau's background investigations both in terms of their length and of the hours staff spent completing them.</li> </ul>
3 Determine whether the commission and the bureau are complying with statutory time frames and internal goals for processing applications for licensing at gaming establishments and whether a backlog of applications exists. Determine the extent and cause of any backlog.	<ul style="list-style-type: none"> <li>Reviewed the commission's and bureau's compliance with statutory and regulatory time frames.</li> <li>Analyzed past bureau reports and current bureau licensing data to identify the number and composition of its pending and backlogged applications during the past five years.</li> <li>Used staffing information and licensing data to analyze the bureau's productivity reviewing applications.</li> </ul>
4 Determine whether the commission and the bureau have and adhere to policies and procedures to ensure all applicants and licensees are treated fairly and consistently by providing timely hearings, due process, and equal protection regardless of race, national origin, or gender.	<ul style="list-style-type: none"> <li>Reviewed commission and bureau policies related to conducting licensing reviews, including background investigations.</li> <li>Reviewed commission licensing meetings and evidentiary hearings to determine their timing and content.</li> <li>To the extent possible, assessed commission and bureau documentation to determine whether applicants received consistent and appropriate levels of review during the licensing process, regardless of race or other characteristics.</li> </ul>
5 Determine whether the commission or the bureau use gambling funds for any improper purposes. Determine how much time their employees spend in each card room and casino and review expenses incurred by these employees while performing their compliance testing.	<ul style="list-style-type: none"> <li>Analyzed Gambling Fund fee revenues and uses for both the commission and the bureau.</li> <li>Reviewed bureau and Justice policies relevant to gaming enforcement, including allowable expenditures.</li> <li>Reviewed a selection of compliance-related expenditures by the bureau's enforcement section.</li> <li>Reviewed time-reporting documentation from the bureau's enforcement section.</li> </ul>
6 Review and evaluate relevant policies and procedures of IGLS and evaluate its efficiency and consistency in reviewing contracts and documents. Determine whether IGLS has and follows policies and procedures to provide all applicants with timely reviews, basic due process, and equal protection requirements regardless of their race or national origin.	<ul style="list-style-type: none"> <li>Reviewed budgetary and time-reporting documentation from IGLS related to the different services it provides to the bureau.</li> <li>Determined that IGLS has no written protocols for reviewing gaming contracts and other documents.</li> <li>Reviewed time frames for contract and other document reviews at IGLS to identify any negative effects on the licensing process.</li> </ul>

*continued on next page . . .*

AUDIT OBJECTIVE	METHOD
<p>7 For a selection of meetings, determine whether the commission complies with the Bagley-Keene Open Meeting Act. Further, for a selection of matters, identify the extent to which the same attorneys are representing both the bureau and the commission and assess whether this arrangement is a conflict of interest or constitutes a violation of the Judicial Code of Ethics or the APA.</p>	<ul style="list-style-type: none"> <li>• Examined the commission's compliance with the Bagley-Keene Open Meeting Act's requirements for both open and closed sessions.</li> <li>• Reviewed the use of attorneys at the bureau and commission to identify any issues regarding compliance with the Judicial Code of Ethics or the APA.</li> </ul>
<p>8 Identify any surplus balance in the Gambling Fund and determine whether fees paid by applicants and licensees are appropriate.</p>	<ul style="list-style-type: none"> <li>• Analyzed historical and projected fund balances to quantify any surplus funds.</li> <li>• Reviewed regulatory gaming fees, including licensing fees and deposits, to determine current fee amounts, revenues, and any stated purpose for those revenues.</li> <li>• Compared fee revenues to the commission's and bureau's estimated expenditures to identify any misaligned fees.</li> </ul>
<p>9 Review and assess any other issues that are significant to the audit.</p>	<ul style="list-style-type: none"> <li>• Reviewed the circumstances behind the bureau's moratorium on licensing certain games and the resulting backlog of games applications.</li> <li>• Determined the bureau's progress in drafting regulations to address its concerns with certain games.</li> <li>• Reviewed the frequency of the commission's evidentiary hearings and considered the costs of holding those hearings.</li> </ul>

Source: Analysis of the Audit Committee's audit request number 2018-132, as well as information and documentation identified in the column titled Method.

### Assessment of Data Reliability

In performing this audit, we relied on electronic data files we obtained from the database the bureau uses to track the status of license applications. The GAO, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of any computer-processed information we use to support our findings, conclusions, or recommendations. To perform this assessment, we evaluated the bureau's data against sources of corroborating documentation from its actual application files. We determined that the data were sufficiently reliable for the purposes of summarizing the number and age of pending applications at the bureau, as well as for determining how long the bureau takes to review license applications.

May 2019

**XAVIER BECERRA**  
*Attorney General*

*State of California*  
**DEPARTMENT OF JUSTICE**



BUREAU OF GAMBLING CONTROL  
2450 DEL PASO ROAD, SUITE 100  
SACRAMENTO, CA 95834  
Public: (916) 830-1700

April 29, 2019

Elaine Howle\*  
California State Auditor  
621 Capitol Mall, Suite 1200  
Sacramento, CA 95814

Re: California State Auditor Report 2018-132; Gambling Control Fund – Revenues, Expenditures, and Use

Dear Ms. Howle:

This letter serves as the Department of Justice's (DOJ) response to the California State Auditor's (CSA) report titled "Report Regarding the Department of Justice's Bureau of Gambling Control and California Gambling Control Commission." DOJ has reviewed the report, agrees with many of the recommendations, and appreciates the opportunity to respond.

The Bureau of Gambling Control (BGC) within DOJ, in conjunction with the California Gambling Control Commission (CGCC), is responsible for ensuring that legal gambling activities in the State of California are conducted honestly, competitively, and free from criminal and corrupt elements as provided in the Gambling Control Act (Act). The Legislature has declared that all persons having a significant involvement in gambling operations must be licensed and regulated to protect the public health, safety, and general welfare of the residents of the state and that public trust and confidence can only be maintained by strict and comprehensive regulation. The State has authorized BGC to investigate the backgrounds of individuals and entities seeking to own or work in gambling establishments (cardrooms) and Third Party Providers of Proposition Player Services (TPPPPS) and BGC takes this responsibility very seriously. Its investigations lead to findings and recommendations which the CGCC considers to ultimately determine who is suitable to own or work in a cardroom.

The Act requires that individuals working in this highly regulated industry be of good character, honesty, and integrity whose prior activities, criminal record, if any, reputation, habits, and associations do not pose a threat to the public interest of the State or to the effective regulation of controlled gambling. BGC conducts investigations on applicants seeking work permits to work as dealers in cardrooms, key employee licenses to work as managers in cardrooms, licenses to own cardrooms, and registrations and licenses for TPPPPS players, supervisors, and owners. The scope of each background investigation conducted by BGC's licensing analysts varies depending on the license type, applicant, and the complexity of the applicant's history.

The level of review in BGC's investigations varies in some respects among different license types according to the degree of influence and control that a position associated with that license type possesses. For example, an investigation for an individual seeking to become a key employee in a cardroom who has decision-making authority will be subjected to a higher level of review than one for an individual seeking a work permit to be a card dealer in a cardroom.

①

\* California State Auditor's comments begin on page 75.

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Cardroom owners require an even higher level of review given their ability to control the operations of the cardroom, including contracts with outside entities that could influence the operations. Below is a chart that broadly summarizes the scope of the various background investigations.

Areas of Investigation	Initial Investigation for Individual					
	Cardroom			Third-Party		
	Work Permit	Key Employee	Owner Individual	Player/ Other	Supervisor	Owner Individual
CA. Criminal History	X	X	X	X	X	X
Federal Criminal History	X	X	X	X	X	X
Gaming Licensing Verification	X	X	X	X	X	X
CJIS	X	X	X	X	X	X
LEIU/Gaming Index	X	X	X	X	X	X
DMV	X	X	X	X	X	X
NLETS	X	X	X	X	X	X
Interpol	X	X	X	X	X	X
Employment History	X	X	X	X	X	X
Credit Report/Bank Statements		X	X		X	X
Military		X	X		X	X
LexisNexis		X	X		X	X
PACER		X	X		X	X
Non-Gaming License Verification		X	X		X	X
CLEAR		X	X		X	X
Litigation Review		X	X		X	X
Contracts/Agreements Review		X	X		X	X
FPPC			X			X
Full Financial Review			X			X

The time it takes to complete an investigation not only varies among the various license types, but also within them. Level I investigations are those that reveal no derogatory information and BGC recommends approval to the CGCC. Level II investigations are those that reveal derogatory information that does not rise to the level of denial and BGC recommends approval to the CGCC. Level III investigations are those that reveal derogatory information and BGC recommends denial to the CGCC. Generally, the higher the level of review, the more complicated and time-consuming the investigation is. Pursuant to statute, BGC must complete applications, to the extent practicable, within 180 days after an application and supplemental information package is determined to be complete. Over the past few years, BGC has been

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working diligently on reducing the number of licensing applications that exceed the 180-day requirement, which has resulted from inadequate staffing levels in previous years. BGC continues to make progress on these cases and believes that increased efficiencies as recommended by CSA, along with additional resources, will facilitate the completion of these cases so that BGC may work towards its goal of consistently meeting its mandate to complete applications within 180 days to the extent practicable.

Below are charts of the cardroom and TPPPSS units' current workload, as well as a chart showing the number of applications BGC has received and completed over the current and past five fiscal years:

#### Age of Pending Cases as of March 31, 2019

Length of Time Pending	Third-Party Provider License Types					Total
	TPPPSS Company	TPPPSS Owner	TPPPSS Supervisor	TPPPSS Player	TPPPSS Contracts / Amendments	
Less Than 180 Days	5	7	63	679	4	758
More Than 180 Days	17	105	292	417	0	831
<b>Total Workload</b>	<b>22</b>	<b>112</b>	<b>355</b>	<b>1,096</b>	<b>4</b>	<b>1,589</b>

Length of Time Pending	Cardroom License Types						Total
	Gambling Establishment	Cardroom Owner	Cardroom Key	Cardroom Work Permit	Gambling Establishment Table Increase Requests	Gambling Establishment Ordinance Reviews	
Less Than 180 Days	0	12	36	51	3	1	103
More Than 180 Days	4	185	89	19	1	0	298
<b>Total Workload</b>	<b>4</b>	<b>197</b>	<b>125</b>	<b>70</b>	<b>4</b>	<b>1</b>	<b>401</b>

#### Cases Received and Completed

Workload Type	FY 13/14 Actual	FY 14/15 Actual	FY 15/16 Actual	FY 16/17 Actual	FY 17/18 Actual	FY 18/19*	Applications Received based on 3-Yr Average	Applications Received based on 5-Yr Average
Renewal Applications Received	1,328	1,765	1,568	1,437	1,208	2,301	1,649	1,656
Initial Applications Received	3,266	3,352	3,811	4,129	3,947	4,067	4,048	3,861
<b>TOTAL APPLICATIONS RECEIVED</b>	<b>4,594</b>	<b>5,117</b>	<b>5,379</b>	<b>5,566</b>	<b>5,155</b>	<b>6,368</b>	<b>5,696</b>	<b>5,517</b>
<i>Percent Increase by Year</i>		11%	5%	3%	-7%	24%		
Renewal Applications Completed	952	1,395	1,523	1,352	1,208	2,045	1,535	1,505
Initial Applications Completed	2,306	2,244	3,403	4,209	3,107	2,951	3,422	3,183
<b>TOTAL APPLICATIONS COMPLETED</b>	<b>3,258</b>	<b>3,639</b>	<b>4,926</b>	<b>5,561</b>	<b>4,315</b>	<b>4,996</b>	<b>4,957</b>	<b>4,687</b>
<i>Percent Increase by Year</i>		12%	35%	13%	-22%	16%		

\*FY 18/19 Includes 9 months actual data plus 3 months projections.

As of March 31, 2019 the BGC received 1,726 renewal applications and 3,050 initial applications, for a total of 4,776 applications received.

As of March 31, 2019 the BGC completed 1,534 renewal applications and 2,213 initial applications, for a total of 3,747 applications completed.

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- ⑤ BGC has already implemented many of the recommendations in the report and is actively developing plans to improve billing practices, policies and procedures for application review, tracking case statuses, and efficiency of staff resources. Our responses to the individual recommendations are as follows:

**CSA Recommendation to the Legislature:**

**1) Temporary funding for 32 positions.**

*Given that the bureau has not achieved the expected benefits from adding 32 additional positions, the Legislature should not approve any requests to make funding for these positions permanent. Instead, the Legislature should extend funding for an additional two years, during which time the bureau should be able to clear its existing number of pending applications. At that point, the Legislature should reevaluate the bureau's long-term staffing needs, taking into consideration the extent to which it has implemented the recommendations in this report.*

**DOJ Response:**

- ⑥ DOJ appreciates the recommendation for retention of the 32 positions while it works to implement changes to improve efficiencies and increase productivity in the Licensing Section. However, it disagrees with the recommendation for temporary two-year funding for all 32 positions and, based on recent analyses conducted, believes that permanent funding for the positions—and for additional positions—are necessary because, once those cases exceeding the 180-day requirement are completed, the positions will be needed to handle the ongoing workload within the 180-day period. Moreover, to the extent that BGC requires additional staff above and beyond the 32-position level, BGC will continue to collaborate with the Department of Finance and the Legislature to acquire supplemental resources with permanent funding. BGC expects to receive over a thousand additional applications this fiscal year from the previous year, including a significant increase in the number of renewal applications that must be renewed every two years. Even assuming a significant increase in productivity due to increased efficiencies, current data indicates that BGC will be unable to address the ongoing workload within the required timeframes without the 32 positions and additional staff.

- ⑥ Below are charts of the average number of hours spent on investigations for each license type. BGC will be reassessing the average hours per review. However, BGC believes that average hours should be used to determine workload as it takes into account the various levels of complexity of investigations for different types of licenses.

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### Average Hours Per Review

Workload Type	INITIAL	RENEWAL
	Hours per Review	Hours per Review
TP Primary Provider	291.0	71.0
GE Owner-Entity	193.0	77.0
GE Owner-Person	168.0	97.0
TP Owner-Person	147.0	97.0
TP Supervisor	128.0	40.0
TP Owner-Entity	79.0	43.0
GE Key Employee Applications	76.0	34.0
Gambling Establishment	30.0	123.0
Ordinance Reviews	30.0	N/A
GE Work Permit - Initial	27.0	3.0
TP Contracts	25.0	44.0
TP Player	22.0	5.0
GE Table Increase Requests	18.0	N/A
TP Contracts - Amendments	12.5	N/A
TP Other Employee	8.0	Unknown
TP Primary Provider Registration	1.0	1.0
TP Owner Entity Registration	1.0	1.0
TP Owner Person Registration	1.0	1.0
TP Supervisor Registration	1.0	1.0
TP Player Registration	1.0	1.0
TP Other Employee Registration	1.0	1.0

Another concern about temporary funding of the positions is the negative impact it may have on BGC's ability to meet its workload demands because it impedes its ability to retain staff. The Licensing analysts are either Staff Services Analysts or Associate Governmental Program Analysts – two classifications that are widely used by all state agencies. Thus, analysts are able to transfer to other departments with vacancies for those classifications. BGC is aware that some analysts are concerned about the expiration of funding for their positions and some have begun looking for job opportunities at other departments.

⑦

When positions are vacated, the entire hiring process takes on average six to seven months to complete. Given the confidential nature of the information that the analysts receive to complete the background investigations, part of the hiring process requires BGC staff to undergo background investigations by DOJ. Thereafter, the training process generally takes six months until an analyst is competent to conduct an investigation independently on the least complicated cases, such as work permits and TPPPPS players. Moreover, experienced analysts will assist with training the new analysts, further impacting the work on background investigations. Once analysts are proficient in the least complicated investigations, they may be moved to work on

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more complicated cases. Accordingly, the impact to retention of Licensing analysts will result in BGC constantly working to fill vacancies and training new staff, at a significant cost, which will negatively impact the efficiencies it is striving to achieve and maintain.

**2) Clear statements about need and use of fees in regulations.**

*To ensure that all fees that generate revenue for the Gambling Fund have clear stated purposes limiting their use, the Legislature should require that when updating fee amounts, the bureau also update its regulations to include clear statements about the need for and appropriate use of each fee type.*

**DOJ Response:**

DOJ agrees with this recommendation. BGC is currently working on evaluating the costs of positions to conduct background investigations and developing regulations to revise the amount of deposits required for investigations. It will include clear statements about the need for and appropriate uses of background-investigation revenue during the regulatory process. Additionally, it agrees that updates to other regulations, including application fees and annual fees set by the Commission, should include these statements as well.

**CSA Recommendations to DOJ:**

**1) Completeness of applications and notifications.**

*To avoid unnecessary delays in its licensing process, the bureau should, by November 2019, begin reviewing applications for completeness upon receiving them. If it determines that an application is incomplete, it should notify the applicant immediately.*

**DOJ Response:**

DOJ agrees with the recommendation and as of April 5, 2019, updated and implemented procedures requiring staff in the Intake Unit to review initial applications for completeness and notify applicants if their applications are complete or incomplete within the required timeframes provided in regulations. DOJ has also updated and implemented procedures as of April 5, 2019, requiring analysts assigned to individual cases to determine if the supplemental information forms are complete and to send the subsequent notifications within the mandated timeframes. Template letters have been created for each notification required for each license type. BGC is also working on automating as many notification letters as possible and determining how it can best utilize existing technology to schedule and track letters to ensure they are sent on a timely basis. BGC will ensure that upgrades to, or replacement of, its current Licensing Information System will include processes to automatically generate and track the notifications. BGC will seek appropriate funding to implement this process.



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**2) Analysis of delays in background investigation process.**

*To help it identify which portions of the background investigation process most contribute to lengthy delays, the Bureau should conduct an analysis of its investigation processes by November 2019 and implement procedural changes to improve its timeliness in processing applications.*

**DOJ Response:**

DOJ agrees with the recommendation and will conduct an analysis of its investigation process to identify delays that can be addressed. Additionally, BGC will no longer grant extensions to applicants requesting additional time to respond to requests for documents and information unless exceptional circumstances exist. BGC previously granted such requests freely, but will no longer do so to eliminate delays during this process.

8

**3) Strategic plan to address applications.**

*To ensure that it approaches its remaining backlog strategically and that it establishes accountability for its use of resources, the bureau should develop and initiate a formal plan by November 2019 for completing the remaining backlogged applications. The plan should identify the license types the bureau will target and the order in which it will target them, along with its rationale for the planned approach. The plan should also include clear goals that identify the numbers of applications it will complete and its time frames for doing so.*

**DOJ Response:**

DOJ agrees with the recommendation and has begun the development of formal strategic plans for reducing the number of pending cases. BGC has reviewed its current data to determine the appropriate and additional staffing levels in the cardroom and TPPPSS units within the Licensing Section and is working on a plan to adjust resources where they are needed. Until an appropriate staffing level is in place, BGC will prioritize its workload, recognizing that it will need to constantly review and shift staff to address workload demands. BGC will formalize plans and include the issues, goals, and timeframes recommended. In addition, BGC will continue to submit Budget Change Proposals to acquire sufficient staffing resources to address increased workload demands.

9

BGC has also reviewed the manner in which it distributes work to its Licensing Section analysts. Rather than assigning staff strictly to one of the six types of applications (cardroom owners, cardroom key employees, cardroom work permits, TPPPSS owners, TPPPSS supervisors, and TPPPSS players), BGC is assigning analysts to other types of applications when appropriate to ensure that staff is actively working on background investigations at all times.

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**4) Prioritization of legal review.**

*To ensure that its licensing process is transparent and consistent, the bureau should implement formal procedures for prioritizing its completion of legal review of ownership applications. The procedures should specify any circumstances that justify reviewing applications out of the order in which the bureau received them.*

**DOJ Response:**

- ⑤ DOJ agrees with the recommendation and as of April 18, 2019, has established formal policy for prioritizing legal review of transactions. As noted in the report, BGC hired a full-time, in-house Deputy Attorney General (DAG) III in October 2018 to assist with the legal review of transactional documents for compliance with laws and regulations, including purchase agreements, trusts, loan agreements, contracts for TPPPPS, and leases. The DAG's responsibilities also include other matters, such as assisting staff with regulations and policy, legislative analysis, legal research, interpretation of the Gambling Control Act, and responses to Public Records Act requests. Prior to hiring the DAG, BGC relied solely on legal services provided by DAGs in the Department's Indian and Gaming Law Section (IGLS). Because of workload demands on DAGs in IGLS, whose priority must be litigation and administrative hearings, BGC hired its own attorney to ensure that transactional reviews could be prioritized and directed by BGC to those transactional documents that require prompt legal review.
- ⑤ BGC has implemented a policy to prioritize the DAG's review of transactional matters that are needed to complete licensing recommendations on cardroom and TPPPPS owner applications to ensure both timely completion of applications, as well as fairness to applicants. The policy directs that legal review of transactions related to owner applications must be handled in the order they are received by BGC, with some exceptions, such as the death of current owners who are distributing shares to applicants and requirements in orders or settlement agreements approved by the CGCC that require the transfer of ownership by specified dates. BGC has developed and implemented a similar policy to prioritize work on owner applications. BGC is currently working with IGLS to take back all transactional work that is currently pending and has not yet been reviewed by IGLS DAGs. The policy regarding prioritization of transactions also will be applied to all work that is reassigned to the BGC DAG.
- ⑤

**5) Games applications.**

*To minimize the degree to which its processes to change its regulations may result in the disparate treatment of card room owners, the bureau should temporarily approve or deny its backlogged games applications by July 2019.*

**DOJ Response:**

DOJ agrees with this recommendation and plans to issue temporary approvals or denials within the timeframe suggested.

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**6) Reporting billable and non-billable time.**

*To ensure it fairly charges applicants for the cost of its licensing activities, the bureau should establish and implement policies by July 2019 to ensure staff properly and equitably report and bill time, including restricting which activities staff may charge to nonbillable and noncase hours. It should also establish clear thresholds for the proportions of time staff may charge to the various categories, as well as procedures for the bureau's management to review compliance with the pertinent restrictions.*

**DOJ Response:**

DOJ agrees with this recommendation and as of April 23, 2019, implemented procedures to ensure the fair and full billing of applicants for the cost of conducting background investigations by BGC. Consistent with the audit recommendation, BGC has revised its policies and practices for billing to ensure that costs are appropriately charged for all investigation work. In addition, it has revised its criteria for non-billable work and developed policy to prohibit any non-billable work on cases unless pre-approved by managers. A report on all non-billable work is generated on a weekly basis and distributed to the Director, Assistant Director of Licensing, and all Licensing Section managers. The first report was generated and distributed on April 24, 2019. Regular meetings are being held to review and discuss all non-billable time to ensure compliance with procedures and to correct any inappropriate authorization of non-billable time. The first meeting was held on April 24, 2019. (5)

As of April 23, 2019, BGC revised its policies and practices for non-case related work. While it understands the concerns and perceptions of work that is not related to specific investigations, it also notes that the time accounted for by analysts as non-case work was for work related to license applications in general, such as purging and organization of old licensing files; work appropriately assigned to analysts in the Licensing Section, such as updates to licensing procedures and assisting with Public Records Act requests; work for which BGC does not have the authority to bill, such as review of local cardroom ordinances and requests to reduce the number of tables in a cardroom; or work-related activities, such as training and staff meetings. BGC has revised its criteria for non-case work and developed policy to prohibit any non-case work unless pre-approved by managers. A report on all non-case work is generated on a weekly basis and distributed to the Director, Assistant Director of Licensing, and all Licensing Section managers. The first report was generated and distributed on April 24, 2019. Regular meetings are being held to review and discuss all non-case time to ensure compliance with procedures and to correct any inappropriate authorization of non-case time. The first meeting was held on April 24, 2019. (5)

BGC will establish thresholds that indicate estimates for acceptable and unacceptable proportions or amounts of time staff may charge to the various categories within the timeframe suggested. (10)

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**7) Cost analyses and fees.**

*To better align the revenue in the Gambling Fund with the costs of the activities that the fund supports, the bureau should conduct cost analyses by July 2020 of those activities. At a minimum, these cost analyses should include the following:*

- *Its personnel costs, operating costs, and any program overhead costs.*
- *Updated time estimates for its core and support activities, such as background investigations.*
- *The cost of its enforcement activities.*

*Using this information, the bureau should reset its regulatory fees to reflect its actual costs. Before conducting its fee study, the bureau should first implement our recommendations to improve its processes for assigning applications, ensuring the completeness of applications, and developing time-reporting protocols.*

**DOJ Response:**

DOJ agrees that application fees and annual fees assessed on cardroom and TPPPPS owners should be reviewed to determine the appropriate level, utilizing the factors suggested in order to better align the cost of activities with the revenue in the Gambling Control Fund. Because these fees are imposed pursuant to regulations developed by the CGCC, BGC will work with the CGCC to provide all necessary information to assist in the development of appropriate fees.

With respect to the deposits BGC receives for background investigations, the amounts are being adjusted to reflect current costs of the positions performing the work. BGC will notify cardroom and TPPPPS representatives before any rate modifications are effective. Additionally, as noted above, it is working on developing regulations to revise the amount of investigation deposits required for investigations and will utilize the data available once recommendations are fully implemented to support adjustments to the deposit amounts.

**8) Background investigation policies and procedures.**

*To ensure that its level of review is commensurate to license type, the Bureau should review and revise each of its background investigation policies as needed by November 2019.*

*To ensure that it treats applicants consistently, the bureau should also begin conducting periodic reviews by November 2019 to determine whether staff are following procedures when conducting background investigations for applicants for all license types.*

**DOJ Response:**

⑤

DOJ agrees with this recommendation. As of April 25, 2019, BGC updated its procedures to correct some differences noted in the report. As of April 25, 2019, it has also combined procedures for work permits, TPPPPS players and supervisors, and key employees into a single set of procedures, and is currently developing a single set of procedures for cardroom and TPPPPS owner license reviews. These procedures will provide additional consistency among

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some of the investigation steps involved in each of the license types and will also allow for additional steps for licenses that require a higher level of review. Additionally, BGC will conduct periodic reviews to determine staff's compliance with procedures within the timeframe suggested.

While BGC understands the need for consistency among application reviews to ensure fairness, it also recognizes that analysts must ask additional questions and sometimes seek other information or documentation to ensure they can adequately assess an applicant's character and support suitability recommendations to the CGCC. Applicants should be treated fairly and consistently, but analysts should consider more than a single issue or piece of information when making conclusions about an individual's character. One issue may not be the only derogatory finding in an individual's background investigation. For example, BGC may not recommend denial for an individual seeking a key employee license who had a single derogatory finding of a bankruptcy within the last ten years, but it may recommend denial for an individual who had a derogatory finding of a bankruptcy within the last ten years, along with multiple delinquent accounts and a history of charge-off accounts. Likewise, BGC may not recommend denial for an individual with a single derogatory finding of a conviction for driving with a suspended license, but it may recommend denial for an individual with a conviction for driving with a suspended license who admits to driving a car to work every day. Each case must be assessed individually and take into account all information. The analysts are required to use their investigative skills, analytical abilities, and articulate their rationale for recommending approval or denial of applications to the CGCC.

⑪

While procedural changes have been made, BGC provides the following input on some of the individual issues addressed by CSA:

⑫

- Check absent parent report: BGC removed this check from procedures as it was duplicative since CGCC checks the absent parent report list.
- Request all applicable database inquiries: BGC agrees that procedures for two license types did not explicitly direct analysts to run checks through the International Criminal Police Organization and National Law Enforcement Telecommunications System, but notes that all other common databases, such as the California Department of Motor Vehicles and the Federal Bureau of Investigations' National Crime Information Center were included in the investigation steps.
- Review disclosure of military history: BGC agrees that the work permit procedures did not require review of military history, but notes that applicants do not need to disclose military history. BGC now requires a check on military history if information regarding prior employment discloses that the applicant worked or served in the military.
- Include failures to appear and unresolved failures to pay in report: BGC agrees that the cardroom owner procedures did not explicitly direct analysts to include these matters in the report to the CGCC, but notes that these issues would appear in the standard database inquiries for a cardroom owner.
- Include real property holdings: BGC agrees that TPPPPS owner procedures noted that real property holdings should be included in the report. In January 2019, this step was removed from future investigations.

⑬

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**9) Records retention.**

*To ensure that it has the ability to justify the results of its background investigations, the bureau should develop a formal record retention policy for application documentation by November 2019. This policy should include rationales for retaining types of documents and should establish a process for ensuring staff compliance.*

**DOJ Response:**

DOJ agrees that BGC must ensure consistent retention of documents for all applications. As of April 22, 2019, BGC simplified its imaging procedures by combining multiple procedures for different license types into one set of procedures. On April 23, 2019, staff was retrained on imaging procedures for files. BGC will develop a formal policy on this matter and include rationales for retaining the various types of documents and a process for ensuring staff compliance within the timeframe suggested.

**10) Reconciliation of funds and time reporting.**

*To ensure that it compensates the Special Distribution Fund for the card room-related enforcement activities for which that fund has paid, the bureau should reconcile the hours due to the Special Distribution Fund at least for the last three fiscal years by November 2019. Moving forward, the bureau should ensure that it provides prompt reimbursement when employees in positions that are funded by one source perform activities that should have been funded by another source.*

*To ensure that its employees allocate their activities to the correct funding sources, the bureau should formalize policies and procedures by July 2019 that provide clear guidelines to employees when reporting time spent on activities that relate to funding sources other than the funding sources for their positions.*

**DOJ Response:**

DOJ agrees with this recommendation and has already taken steps to reconcile the personnel hours supported by the Gambling Control Fund and the Special Distribution Fund when staff time is split between the two fund sources. BGC began reviewing this matter last year and implemented a procedure to correct the allocation of expenditures quarterly beginning in the second and third quarters of Fiscal Year 2018-19. During this process, BGC provided additional direction to staff in its Compliance and Enforcement Section regarding accurate time reporting, which it has incorporated into policy as of April 26, 2019. Additionally, BGC has corrected expenditures for Fiscal Years 2016-17 and 2017-18 and the first quarter of Fiscal Year 2018-19. BGC will conduct an ongoing review of expenditures after every quarter (three months) and submit requests to reconcile funds between the Gambling Control Fund and the Special Distribution Fund to DOJ's Accounting Office pursuant to a procedure issued on April 26, 2019, outlining this process.

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**11) Time tracking at cardrooms and casinos.**

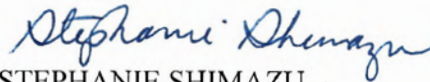
*To ensure that it can provide useful and accurate data on the locations where enforcement employees spent their time, the bureau should equip its time-reporting system by November 2019 with the capability to track all hours employees spend at each cardroom and casino.*

**DOJ Response:**

DOJ agrees with the recommendation and is working to determine the necessary modifications to the current time-reporting systems to track all hours that staff in the Compliance and Enforcement section spends at each cardroom and casino. BGC will seek appropriate funding to implement this process.

Thank you again for the opportunity to review and comment on the draft audit report. If you have any questions or concerns regarding this matter, please contact me at the telephone number listed above.

Sincerely,



STEPHANIE SHIMAZU  
Director

For XAVIER BECERRA  
Attorney General

cc: Sean McCluskie, Chief Deputy Attorney General  
Kevin Gardner, Chief, Division of Law Enforcement  
Chris Ryan, Chief, Division of Operations  
Chris Prasad, CPA, CFE Director, Office of Program Oversight and Accountability

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## Comments

### CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE DEPARTMENT OF JUSTICE'S BUREAU OF GAMBLING CONTROL

To provide clarity and perspective, we are commenting on the bureau's response to the audit. The numbers below correspond to the numbers we have placed in the margin of its response.

Although we acknowledge on page 46 that we expected that the bureau would subject applicants for some types of licenses to more thorough levels of review than others, we go on to state on pages 46 and 47 that we found that the bureau's background investigation procedures vary considerably for different types of licenses and do not always reflect the associated level of responsibility.

①

The bureau's presentation of its background investigation procedures in this table is inconsistent with the results of our review. Specifically, as Table 6 on page 47 demonstrates, the bureau's background investigation procedures for card room owners and third-party players do not contain all relevant database inquiries. The bureau acknowledges this inconsistency, among others, on page 71.

②

We disagree with the bureau's characterization that it continues to make progress on its backlogged cases, but needs additional resources to complete them all. As we explain on page 21, despite already receiving significant staff increases, the bureau has made only moderate progress in reviewing pending applications. Further, although we have not reviewed the bureau's data as of the March 31, 2019 date it reports here, we note that the number of backlogged applications it reports—those older than 180 days—has increased since the December 2018 date of the data we reviewed, from 957 to more than 1,100.

③

We are uncertain how the bureau obtained the numbers it presents in this table, which are slightly different than those we calculated. Specifically, the bureau's numbers for incoming applications for fiscal years 2014–15 through 2017–18 are up to 3 percent lower and its numbers for reviewed applications are 4 percent higher for fiscal year 2017–18 than the audited numbers we present in Figure 6 on page 22. When the bureau provided its fiscal year 2018–19 budget change proposal to us, which included the same numbers it reports here, we asked for and received the data it used to compile the licensing statistics in the proposal. We then performed an independent analysis of this data to arrive at the numbers we include in this report and in Figure 6. Although we stand by the data

④

and analysis in our report, we also note that the bureau's numbers lead to the same conclusions we reach in our report regarding its decreasing productivity.

- ⑤ Throughout its response, the bureau references changes to its policies, practices, and procedures it has made as a result of our recommendations. The changes it describes are very recent—some as recent as the period of the bureau's review of our draft report. Therefore, we have not received and reviewed any documentation to substantiate them. We look forward to reviewing the adequacy of these changes as part of the bureau's 60-day response to our audit report, which should detail its progress in implementing our recommendations.
- ⑥ Although the bureau disagrees with our recommendation to extend temporary funding for two years rather than making the funding permanent, it has not provided us with any analysis justifying a permanent staffing level that includes the 32 positions, despite our request. It also did not provide this information in its response. As we state on page 25, the bureau has not sufficiently demonstrated the number of permanent card room and third-party licensing staff it needs. Specifically, the bureau has not updated its per-application time estimates for many license types since 2015, and for those it has updated, the bureau's per-application estimates increased significantly. Finally, although the bureau references increases in the number of incoming applications during fiscal year 2018–19, this is not information the bureau provided previously; therefore, we cannot comment on its validity. As we note on page 21, the number of incoming applications increased only marginally in fiscal years 2015–16 and 2016–17 and actually decreased in fiscal year 2017–18.
- ⑦ Although the bureau expresses concern about temporary funding for the positions because it impedes its ability to retain staff, our review found that the bureau's filled licensing positions increased each year over the period we reviewed from fiscal year 2014–15 through fiscal year 2017–18. Further, although we understand that the bureau may face administrative challenges related to temporarily funded positions, we do not believe that those challenges justify addressing what should be a temporary project—clearing the backlog of applications—with permanent funding. As we state on page 26, once it has cleared its pending applications, the bureau is likely to need some of the 32 positions on a permanent basis. However, determining the appropriate number of positions will require the bureau to take steps to improve its productivity and then reassess how many positions it needs on a permanent basis.

We are concerned by the bureau's statement that it will no longer grant extensions to applicants requesting additional time to respond to requests for documentation and information unless exceptional circumstances exist. As we state on page 16, the bureau has not completed a review to determine what steps of its background investigation process may be contributing to delays. Also, we explain on page 15 that the bureau's failure to promptly assess the information it requests likely exacerbated overall delays. Consequently, we believe it is premature for the bureau to conclude that applicants' requests for extensions should no longer be granted.

⑧

The bureau asserts it has reviewed current data to determine appropriate additional staffing levels. As we discuss in comment 6 above, the bureau's current data in this area are outdated, having not been updated for many license applications types since 2015. Its failure to update this data is one of several reasons we discuss throughout the report why the bureau has not sufficiently demonstrated what an appropriate staffing level should be. As we state on page 26, once it has cleared its pending applications, the bureau is likely to need some of the 32 positions on a permanent basis. After it clears these applications and takes steps to improve its productivity, it will be better positioned to reassess how many positions it needs. Although implementing a formal plan is an important part of that process, we stand by our recommendation that the Legislature not approve any requests to make permanent any temporary funding for the bureau's positions, and should reevaluate the bureau's long-term staffing needs in two years' time, taking into account the extent to which it has implemented the recommendations in this report.

⑨

The bureau's response attempts to minimize our finding by stating that the time accounted for by analysts as noncase work was for work related to license applications in general and by providing various other activities for which this time accounts. However, this noncase time represents 45,700 hours of staff time in fiscal year 2017-18—nearly half of all reported staff time in the licensing division. As we state on page 41, considering the persistent backlog of applications, we are concerned that staff have reported so much of their time on activities unrelated to reviewing applications and conducting background investigations.

⑩

The bureau's statement that each case must be assessed individually does not absolve it of its responsibility to ensure that all applicants receive consistent treatment. This need for consistent treatment is especially true since—as we state on page 46—the bureau has broad discretion in processing license applications and determining applicants' suitability. Therefore, we stand by our recommendations

⑪

that it review and revise each of its background investigation procedures and also begin periodically reviewing whether its staff follow those procedures for all license types.

- ⑫ We appreciate that the bureau indicates that it has taken steps to address some of the inconsistencies in its background investigation procedures. Although the bureau's response tries to downplay the bad effects of these inconsistencies, we stand by our conclusion on page 49 that, by failing to ensure its procedures subject applicants to equal treatment and that staff consistently follow those procedures, the bureau risks subjecting some applicants to greater scrutiny than others without justification.
- ⑬ The bureau misses the point of our finding. The bureau's response states that these issues would appear in the standard database inquiries for a card room owner applicant. However, our finding, as Table 6 on page 47 illustrates, is that the bureau's procedures do not consistently require staff to include the results of these inquiries in bureau reports to the commission.

May 2019



STATE OF CALIFORNIA

**GAMBLING CONTROL COMMISSION**

2399 Gateway Oaks Drive, Suite 220  
Sacramento, CA 95833-4231  
(916) 263-0700 Phone  
(916) 263-0499 Fax  
www.cgcc.ca.gov

Gavin Newsom, Governor

JIM EVANS, CHAIRMAN  
PAULA LABRIE  
GARETH LACY  
TRANG TO

May 1, 2019

Elaine M. Howle, CPA\*  
California State Auditor  
621 Capitol Mall, Suite 1200  
Sacramento, CA 95814

Re: Audit Report 2018-132

Dear Ms. Howle:

The California Gambling Control Commission (Commission) has reviewed the redacted draft California State Auditor's (CSA) report regarding the Department of Justice's Bureau of Gambling Control (Bureau) and the California Gambling Control Commission.

As you are now aware, the Commission is a small, yet highly productive agency. The Commissioners and 29 staff members take great pride in our work and take our role and responsibilities seriously. The Commission-specific recommendations provided are appreciated, and align with our ongoing regulatory efforts. We agree that some of the recommendations would require the legislature to amend existing laws.

In response to the CSA's Commission-specific recommendations identified in the draft report, the Commission submits the following response and important context:

**CSA Recommendation:**

*To prevent delays and the unnecessary use of resources, the commission should, following the Legislature's amendment to the law that we recommend, revise its relevant regulations to specify that it is not required to hold evidentiary hearings unless applicants request that it do so.*

**Commission Response:**

The Commission agrees with this recommendation, in part.

The Commission is in support of a recommended change to existing law to allow swifter denial actions – in some circumstances – at a regular public meeting, rather

\* California State Auditor's comments begin on page 87.

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① than through a separate evidentiary hearing. As the recommendation and various sections of the report point out, applicants must be afforded due process before the Commission can take adverse action against an individual. When a licensing decision takes longer than the self-imposed 120 days, it is because the Commission is complying with the existing due process requirements of the Gambling Control Act. Existing regulations require the Commission to allow applicants no less than 60 days from the date of hearing notice to prepare for the hearing. This requirement seeks to balance the need for swift action with the opportunity for applicants to prepare for the hearing, particularly the majority of applicants who are not represented by an attorney. The Commission supports potential modifications to timelines so long as the twin goals of speedy action and due process can both be achieved. To that end, we are working to address this issue and posted a public notice about a potential regulatory change to Title 4, California Code of Regulations Division 18 sections 12221.87, 12235, 12342 and 12350. The proposal, in part, would modify these sections so that the Commission takes **action on** an application within 120 days after the corresponding Bureau report is submitted to the Commission.

② In addition to maintaining the applicants' continued right to request an evidentiary hearing, it is imperative that the Commissioners also retain discretion to hold an evidentiary hearing when more information is needed to determine the applicant's suitability for licensure. A separate hearing ensures the applicant provides testimony under oath and has an opportunity to submit evidence in support of his or her application. While these aforementioned elements could be introduced at a licensing meeting, it is unclear whether doing so would save time or would simply change the forum where the dialog with an applicant is conducted. For example, an applicant may still want to introduce evidence and call witnesses subject to cross examination. Regardless, the Commission strongly supports exploring potential new ways to adjudicate licensing matters in a fair and efficient manner.

#### **CSA Recommendation:**

*To ensure it has comprehensive licensing information to determine ongoing workload and staffing needs, the commission should implement procedures for tracking the number of license applications it receives from the bureau each fiscal year and the outcomes of those applications, such as denials.*

#### **Commission Response:**

The Commission agrees with this recommendation.

③ The Bureau's Licensing Information System (LIS) contains all application data. The Commission has been working with the Bureau on its effort to potentially modify and update LIS. With certain changes, the Bureau's LIS could be utilized to track the number of applications and their outcome. We will continue to support any such effort. In addition, in July 2018 the Commission created an internal database to track information about actions taken at Commission licensing meetings. The Commission

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will continue to endeavor towards more robust reporting through this database, which will also include the tracking of all licensing outcomes on applications received by the Bureau.

#### **CSA Recommendation:**

*To prevent unnecessary delays and use of resources, and to ensure its compliance with state law, the commission should, following the Legislature's amendments of the Gambling [Control] Act that we recommend, revise its regulations and policies for conducting evidentiary hearings. These revisions should specify that the commission may vote at regular meetings on a final basis to approve or deny licenses, registrations, permits, findings of suitability, or other matters and that it is not required to conduct evidentiary hearings unless applicants request that it do so.*

#### **Commission Response:**

The Commission agrees with this recommendation, in part.

As stated above, the Commission's hearing regulations are in place specifically to comply with current statutory requirements within the Gambling Control Act, to ensure applicants are provided due process, and provide sufficient time for applicants sent to an evidentiary hearing to prepare their case before the Commission. As stated above, the vast majority of individual applicants are not represented by an attorney or representative. The Commission welcomes a statutory revision that would allow the Commissioners to approve or deny applicants at its regular meetings and also continue to allow for separate hearings when necessary for the Commission to reach a decision or when requested by an applicant. ④

As it relates to this particular section of the audit report, it's important to provide the following context:

In two places, the audit report states that the Commission approves a "majority" of applicants at a regular licensing meeting, but, in fact, the Commission approves 99% of applicants at its regular licensing meetings within the previously mentioned self-imposed 120 day time frame. In other words, only 1% of applicants today require an evidentiary hearing for the Commission to make a licensing decision. In one place, the report more accurately states that the "commission refers only a small fraction of the applicants...to evidentiary hearing." However, in the same section, the report states that seven of the 18 applications reviewed by the CSA were referred to an evidentiary hearing (over 38%). Again, that ratio is not representative of the actual percentage of applicants that are referred to an evidentiary hearing, which is approximately 1% of all applications received. Moreover, this recommendation ignores the very real possibility that most, if not all, applicants that are ostensibly denied would still request an evidentiary hearing as reflected by the large number of applicants who currently request an evidentiary hearing. ⑤ ⑥ ⑦

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### CSA Recommendation:

*To better align the revenue in the Gambling [Control] Fund with the costs of the activities that the fund support, [redacted text] the commission should conduct cost analyses by July 2020 of those activities. At a minimum, these cost analyses should include the following:*

- *Their personnel costs, operating costs, and any program overhead costs.*
- *Updated time estimates for their core and support activities, such as background investigations.*
- *The cost of their enforcement activities.*

*Using this information, the [redacted text] commission should reset their regulatory fees to reflect their actual costs.*

### Commission Response:

The Commission agrees with this recommendation, in part.

The audit report asserts that existing licensing fees are not high enough to recover the associated expenditures and that the non-licensing fees exceed corresponding expenditures. It is important to highlight that the licensing fees are associated with the application and background fees primarily paid by individual applicants, including individuals who are making minimum wage. In regards to the non-licensing fees being in excess of the corresponding expenditures, these are annual fees paid by owners of the cardrooms and Third-Party Providers of Proposition Player Services businesses. Once the new fees are identified and prior to revising its regulations, the Commission will need to identify the impact any increased fees may have on the industry as a whole—not just owners and businesses, but also the individual applicants.

- ⑧ In any event, the Commission's costs are known and defined. In any discussion of fee adjustment, the Bureau and the Legislature (through the budget process) should evaluate and determine how much it costs to effectively regulate gambling in California. For example, such assessment could help determine the appropriate funding and resources required to protect the public, such as: additional agents for compliance checks; additional analysts to eliminate the existing backlog of licensing applications; additional attorneys to reduce the time associated with conducting legal reviews and handling administrative proceedings; and forensic accountants to analyze increasingly complex financial transactions. This determination by the Bureau, working with the Legislature, is a necessary part of any assessment of the fees used to support the cost of effective regulation. This assessment is complicated by the fact that entities, which are not under the Commission's jurisdiction, will be an essential component of this task.
- ⑨ Based on these factors, we anticipate that December 2020 is a realistic completion target date.



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Regardless of the outcome of this assessment, there are fees that the Commission does not have discretion to change. For example, the non-licensing annual fees are set in statute. In those cases where statutory changes are necessary, the Commission will work with the Legislature on any proposed statutory changes. ⑩

#### **CSA Recommendation:**

*To increase uniformity in the licensing process, the commission should revise its current regulations and submit them to the Office of Administrative Law for public review by May 2020 to address the following areas of inconsistency:*

- *Application processes and time frames.*
- *The ability to work during the application process.*
- *The ability to reapply after denial.*

*In revising its regulations, the commission should increase consistency across application types while minimizing risk to the public.*

#### **Commission Response:**

The Commission agrees with this recommendation, in part.

The ongoing revision of the Commission's licensing regulations is arguably its largest and most all-encompassing regulatory package to date – it alone currently stands at approximately 200 pages. For context, the length of all currently enacted Commission regulations stands at roughly 218 pages, meaning that the forthcoming package would affect nearly 92% of all regulations currently adopted by the Commission. This is a significant undertaking not to be taken haphazardly.

The Commission has held multiple meetings with stakeholders and consultations with the Gaming Policy Advisory Committee to ensure the package delivers better consistency across license types and clarifies processes. Each meeting has resulted in significant changes to the package. The Administrative Procedures Act requires agencies to develop regulations that are complex or contain a large number of proposals that would not be easily reviewed during the comment period to involve stakeholders prior to public notice with OAL.

We are on schedule to submit these regulatory improvements in June 2020 through a process that ensures opportunity for the public to review and comment on the regulations and for further revisions to be based if necessary. In particular, the Commission works with its partnering agencies and industry to seek input prior to the formal rulemaking process to provide an extra opportunity for engagement and sufficient time for all stakeholders to evaluate the proposal and consider any potential impacts on existing business practices. This process may include multiple periods of public input before noticing a regulation to OAL. ⑪

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### CSA Recommendation:

*To ensure that it does not hold hearings that may cause applicants unnecessary harm, the commission should, following the Legislature's revisions of state law that we previously recommended, establish and implement formal protocols for informing applicants how to withdraw their requests for hearings and guiding commission staff when discontinuing the hearing process at the request of applicants.*

### Commission Response:

The Commission agrees with this recommendation, in part.

- ⑫⑬ Prior to the audit, the Commission had a policy of what constituted a formal withdrawal of an applicant's request for a hearing, which is noted in the final draft report on page 36. In response to the auditor's recommendation, that policy has now been included in internal written procedures. The Commission also previously provided information on withdrawing a hearing request to applicants in specific circumstances, such as when the applicant didn't show for their scheduled pre-hearing conference. Again, in response to the auditor's recommendation, the Commission has implemented formal protocols to inform **all** applicants how to withdraw their hearing requests and to guide Commission staff when discontinuing the hearing process.

- ⑭ While the Gambling Control Act gives the Commission broad discretion in making determinations about individual applicants, the Commission also strives to avoid unnecessary disclosure of embarrassing or harmful information about an applicant in its published decisions. However, a request by an applicant to avoid the hearing process should not, for the sake of efficiency or consistency, unduly limit the Commission's ability to take evidence submitted by the Bureau on an applicant's suitability (i.e., character, integrity, honesty, or the threat to the effective control of controlled gambling).

- ⑮ Simply put, there are circumstances where a decision on the merits is in the best interest of the public, even if an applicant seeks to withdraw their request for a hearing. For example, the public may be better protected by a detailed factual finding on the record for an applicant who was terminated for embezzlement from a gambling establishment, but never criminally prosecuted. Without the discretion to make fact based decisions, even when an applicant seeks to avoid the process, some applicants' misdeeds would go unrecorded and unestablished for possible future applications within the jurisdiction of the Commission and/or others, gambling related or otherwise. This policy is accurately reflected with respect to the limited ability to withdraw an application following the Bureau issuing its recommendation, as mandated by the Legislature, and the broad discretion provided to the Commission in considering the requests (Business and Professions Code Section 19869). Moreover, while evidence can be lost over time, evidence submitted through documents and testimony provided at a Commission's evidentiary hearing is preserved as it becomes part of the official record.

Elaine M. Howle, State Auditor  
May 1, 2019  
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Finally, while the Commission strives for efficiency and consistency it also takes seriously the due process protections that ensure an applicant who has requested a hearing is afforded a hearing. Once an application is referred to an evidentiary hearing, the hearing notice time and the process for an applicant to withdraw a request for a hearing are designed to ensure the applicant's due process rights are protected. While this process may not always be efficient, it is necessary to ensure all applicants receive notice and a fair opportunity to be heard. Our revised written hearing notices help ensure that if these applicants later change their mind, they are informed how to officially notify the Commission of their desire to withdraw their request for a hearing.

(14)

Thank you for the opportunity to review and comment on the draft audit report. If you have any questions, you may contact me at (916) 263-0700.

Sincerely,



STACEY LUNA BAXTER, Executive Director  
California Gambling Control Commission

cc: Commissioners  
R. Todd Vlaanderen, Chief Counsel  
Adrianna Alcala-Beshara, Deputy Director, Licensing Division  
Alana Carter, Deputy Director, Administration Division

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## Comments

### CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CALIFORNIA GAMBLING CONTROL COMMISSION

To provide clarity and perspective, we are commenting on the commission's response to the audit. The numbers below correspond to the numbers we have placed in the margin of its response.

The commission conflates the statutory requirements in the Gambling Act with those in its own regulations. The time frames that the commission specifies are of those in its regulations. As we discuss on page 27, when the commission amended its regulations in 2015 it established new time frames for cases it refers to evidentiary hearings, requiring a minimum of 60 days advance notice to applicants and an allowance of up to 75 days to issue a decision after the hearings—a total of 135 days. This allowance of 135 days introduced a potential conflict with the 120-day requirement in its existing regulations. Moreover, the commission's proposal to modify regulations will not help address the delays we identified. Instead, the proposed changes would relieve the commission of the current requirement to approve or deny an application within 120 days. Finally, as we state on page 28, the commission's regulations allow it to approve licenses during regular meetings, whereas the law requires the same meeting standards for approvals and denials. Therefore, legislative action, which we recommend on page 29, is necessary to allow the commission to make needed adjustments to its regulations and policies.

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We do not agree with the commission's claim that it is unclear whether our recommendation would save time, nor does the recommendation attempt to constrain the commission's discretion for holding evidentiary hearings when necessary. Instead, our recommendation on page 30 is intended to address the extent to which unnecessary hearings contribute to delays and the use of state resources. As we discuss on page 28, the frequency of evidentiary hearings increased from 12 in 2014 to 34 in 2018 and that an evidentiary hearing is generally the second time the commission considers an application. In addition, as we state on page 29, of the seven applicants we reviewed whom the commission referred to evidentiary hearings, four informed the commission beforehand that they would not attend the hearings or stopped participating in the prehearing process, yet the commission still held three of those hearing in the applicants' absence. As such, the additional and unnecessary costs in time and resources under the current approach are apparent.

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- ③ The commission provided its internal database to us but, as we note on page 27 of our report, the commission does not currently have comprehensive data regarding the number of incoming licensing applications or the outcomes of those applications, such as how many it has denied or approved. As such, the need for our recommendation on page 30 remains.
- ④ The commission's statement that its hearing regulations are in place specifically to comply with current statutory requirements within the Gambling Act is misleading. The commission's regulations do not fully comply with the Gambling Act because, as we describe in comment 1 above and state on page 28, commission regulations allow it to approve licenses during regular meetings, whereas the law requires the same meeting standards for approvals and denials.
- ⑤ The commission's critique of our report text and its statement that it approves 99 percent of applicants at its regular licensing meetings are disingenuous. The text we use is appropriate because, as we state on page 27, the commission's executive director confirmed that the commission does not currently have comprehensive data regarding the number of incoming licensing applications or the outcomes of those applications, such as how many it has denied or approved. This was the basis for our recommendation on page 30 that the commission implement procedures for tracking this information—a recommendation with which the commission agrees. Therefore, if the commission possesses this information, it has not provided it to us and we are unable to speak to its validity.
- ⑥ The commission misunderstands the purpose of our review. Our selection of applicants for review included both approved and denied applications from a variety of licensing types in order to review the commission's handling of those applications and to determine whether any improper or inconsistent use of the commission's processes contributed to unequal treatment. It was not a statistical sample, as the commission implies.
- ⑦ Contrary to the commission's statement about our recommendation, we did consider whether most, if not all, applicants that are denied would still request an evidentiary hearing. As we state on page 51, after deciding to hold a hearing, the commission sends a form asking applicants to formally request a hearing. Therefore, applicants wanting to obtain a license will most likely return the form to request a hearing because a hearing represents their only opportunity to be considered for a license. If the commission was able to consider and deny applications at regular meetings, applicants might not insist on additional proceedings. Further, even under the current approach, as we state on page 29, four of the seven applicants we reviewed whom the commission referred to hearings subsequently decided not

to attend their hearings. Further, as we explain on page 28, the number of hearings—and therefore, presumably, hearing requests—increased substantially when the commission began its current approach, from 12 in 2014 to 34 in 2018. Therefore, we stand by the recommendation’s potential to increase efficiency.

The commission’s statement that its costs are known and defined—in the context of the specific activities that correspond to fee amounts—is inaccurate. The reason we took the approach we did to estimate licensing and nonlicensing expenditures, and the reason we make our recommendation on page 42, is because the commission had not conducted cost analyses in these areas.

We are concerned with the commission’s claims about how long it anticipates it will take to implement our recommendation. The recommendation, on page 42 of the report, is directed at both the commission and the bureau, and fully contemplates their need to work together to align fees and their uses. However, we take issue with the commission’s claim that the need to work together justifies a time frame of more than a year and a half. Ensuring fee amounts are appropriate is not a new responsibility for the commission. However, the commission did not take action regarding its misaligned fees while the Gambling Fund balance more than doubled from \$30 million at the end of fiscal year 2013–14 to \$61 million at the end of fiscal year 2017–18, as we explain on page 35. Also on page 35, we discuss that the January 2019 Governor’s proposed budget includes loan repayments to the Gambling Fund and that will increase the fund balance to more than \$97 million by June 2020—a surplus of more than five times the bureau’s and commission’s projected annual expenditures. Given the urgency and magnitude of the issue and the commission’s lack of action to date, we urge the commission to do all it can to meet the time frame of July 2020 that we set in our recommendation on page 42.

To clarify the commission’s statement, not all nonlicensing annual fees are set in statute. As we explain in the footnote on page 31, card room fees are set in the Gambling Act as well as in the commission’s regulations. However, nonlicensing fees paid by third-party company owners, which generate the majority of nonlicensing revenue, are only in the commission’s regulations. Regardless, the commission is responsible for ensuring fees are appropriate, and we appreciate that the commission indicates that it will fulfill this responsibility by proposing statutory changes where necessary.

The commission appears to disagree with the implementation date of May 2020 of our recommendation for revising its licensing regulations and submitting them to the Office of Administrative Law

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for public review, as it states that it is on schedule to submit them in June 2020. To increase uniformity in the licensing process and address current consistencies as soon as possible, we urge the commission to do all it can to meet the May 2020 time frame.

- ⑫ The commission's response uses page number references from a draft copy of our report. Since we provided the commission the draft copy, page numbers have shifted.
- ⑬ The commission's response mischaracterizes our report text as well as its own practices at the time of our audit. The text the commission references, now on page 52 of the report, does not conclude that the commission had a policy in place regarding what constituted a formal withdrawal of an applicant's request for a hearing. Instead, it relays an explanation by the chief counsel that to cancel evidentiary hearings, the commission requires applicants to explicitly waive their rights to that hearing. Later in the same paragraph, we note that the commission has not established any formal procedures to guide staff on how to handle instances when applicants opt out of the hearing process before the hearings occur, nor for providing explicit instructions to applicants on how to opt out.

Further, the commission's response states that it previously provided information on withdrawing a hearing request to applicants. We reviewed this information during our audit and determined it did not contain clear guidance about how to withdraw from the hearing process. Specifically, the information instructs applicants to contact the commission if they do not plan to attend their hearing or if they would like to withdraw their request for a hearing, but does not make it sufficiently clear that these are two different things; as we state on page 51, even though applicants we reviewed told the commission at least two weeks in advance that they no longer wanted to attend, the commission held the hearings in both cases. Further, information the commission provides to applicants instructs them to contact the commission via telephone, even though the commission's chief counsel told us it requires applicants to withdraw their requests in writing.

- ⑭ We have not had the opportunity to review these new procedures. As we state on pages 52 and 53, after we shared our concerns with the commission, its executive director informed us that it was taking steps to provide specific direction to applicants, as well as to develop internal procedures. The commission very recently shared its new procedures with us during the period of its review of our draft audit report. As a result of this timing, we are unable to conclude whether those procedures adequately address our concerns; we look forward to doing so during our review of the



commission's 60-day response to our audit, which should detail its progress in implementing our recommendations. Also, we note that fully resolving this issue will ultimately require the Legislature to amend the law to allow the commission more flexibility when denying applicants, as we conclude on page 53.

We take issue with the commission's claim that it strives to avoid unnecessary disclosure of embarrassing or harmful information about applicants in its published decisions; we observed instances in which its decisions included this information unnecessarily. Further, the commission's argument that there are circumstances where a decision on the merits is in the best interest of the public is not responsive to the circumstances that led to this recommendation, despite our clearly stating them in our report. We do not dispute that the commission may reasonably decide an application on the merits, even if an applicant does not participate. In fact, we clearly state on page 52 that in these instances the commission may need to include details about an applicant's background in its written decision to show the basis for that decision. However, as we explain on page 51 of the report, we identified two instances in which the commission's written decisions included criminal background information about the applicants even though the commission did not rely on this information in its reasons for denying the applications. These are the situations our recommendation on page 53 is intended to prevent.

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