

Indian Gaming Special Distribution Fund

Local Governments Do Not Always Use It to Mitigate the Impacts of Casinos, and Its Viability Will Be Adversely Affected by Compact Amendments

REPORT NUMBER 2006-036, JULY 2007

California Gambling Control Commission's and Six County Indian Gaming Local Community Benefit Committees' responses as of September 2007

Government Code, Section 12717, requires the Bureau of State Audits (bureau) to conduct an audit every three years regarding the allocation and uses of moneys from the Indian Gaming Special Distribution Fund (distribution fund) by the recipients of the grant money and report its findings to the Legislature and all other appropriate entities. We evaluated the use and administration of distribution fund grants at six counties: Fresno, Placer, Riverside, San Bernardino, San Diego, and Sonoma.

We also compared fiscal year 2005–06 distribution fund contributions to estimated future contributions based on changes in compact provisions in new and amended pending compacts to determine the ability of the distribution fund to continue to fund the programs that depend on it. We then compared estimated contributions to current year expenditures from the distribution fund. Because we are unable to project how fast casinos will expand or forecast the changes to their profitability, we made a conservative estimate based on fiscal year 2005–06 gaming device counts and net win figures.

In his fiscal year 2007–08 veto message, the governor deleted the appropriation for grants to local government agencies to mitigate the impact of casinos. However, Assembly Bill 1389 (AB 1389) would appropriate \$30 million from the distribution fund to provide grants to local jurisdictions subject to several provisions. Finally, several counties stated in their response that the recommendations addressed to their respective Local Community Benefit Committee (benefit committee) for improving the process would not be considered until funding is restored.

Finding #1: Local governments did not always use the distribution fund to pay for mitigation projects.

The legislation establishing the distribution fund declares the intent of the Legislature that tribal governments participate in identifying and funding mitigation of the impacts of tribal gaming through the grant process. The legislation also states that the grants are for distribution to local governments impacted by casinos. Finally, the senate floor analysis describes the legislation creating the distribution fund and grant process as establishing “priorities and procedures . . . for the purpose of mitigating impacts from tribal casinos.” However, the legislation does not establish a clear requirement that the grants be used only for projects that actually mitigate the impacts from tribal casinos in all instances.

Audit Highlights . . .

Our review of the allocation and uses of the Indian Gaming Special Distribution Fund (distribution fund) money revealed the following:

- » *Local governments did not always use distribution fund money to mitigate casino impacts.*
- » *The allocation of distribution fund money in some counties is based, in part, on the number of devices operated by tribes that did not pay into the fund because their compacts require them to negotiate directly with the county to pay for the mitigation of casino impacts. However, these counties continue to receive distribution fund dollars from the State.*
- » *In many instances local governments do not use interest earned on unspent distribution fund money for projects related to casino impacts.*
- » *Although all benefit committee members are required to file statements of economic interests, in our sample counties, 11 of the 13 tribal members that were required to file failed to do so.*
- » *The ratification of compacts in June 2007, along with one that is awaiting ratification, may threaten the future viability of the distribution fund and the programs that depend on it, as they eliminate \$92 million in payments to the fund beginning in fiscal year 2007–08. While we estimate that contributions to the State's General Fund would also total at least \$174 million, almost \$40 million per year could be required to pay for the estimated shortfall in the Revenue Sharing Trust Fund.*

Based on our review of 30 grants, we determined that often a distribution fund grant financed a project that had the potential of offsetting the repercussions of a casino but was mainly used for activities that benefited the county as a whole. In 10 instances, the goods and services purchased with grant money had the potential for use in mitigating casinos' impact, should the need arise. However the main beneficiaries were the counties as a whole. Even though the potential exists that some of the goods or services acquired with these grant funds could be used to mitigate the impact of a casino, it is unclear whether the Legislature intended distribution fund grants to be used in this manner. In other cases grant funds were used for projects totally unrelated to casinos. Specifically, in five instances the money was not used to offset the adverse effects of casinos. Although these and other purchases may be beneficial to the counties, when a distribution fund grant is used for purposes that have little or no relationship to a casino impact, the problems the community experiences because of a casino may not be adequately addressed. The remaining 15 grants we reviewed were used specifically to alleviate casino impacts.

We recommended that the California Gambling Control Commission (gambling commission) seek legislative changes to amend the government code to provide direction to local governments to ensure that they use distribution fund grants only to purchase goods and services that directly mitigate the adverse impacts of casinos on local governments and their citizens.

We also recommended that benefit committees require local governments to submit supporting documentation that clearly demonstrates how proposed projects will mitigate the effects of casinos.

Gambling Commission's Action: None.

- ➔ The gambling commission states that because it does not have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which requires that benefit committees select only grant applications that directly mitigate impacts from casinos, and cause any grant for expenditures not related to Indian Gaming to terminate immediately and revert to the Individual Tribal Casino Account. Further, the bill requires that if an expenditure to mitigate the impact of a casino provides other benefits to the local jurisdiction, the grant may only finance the proportionate share of the expenditure that directly mitigates the impact from the casino. This bill was referred to the committee on governmental organization on December 13, 2007.

Fresno County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it is working with staff to codify more comprehensive descriptions and procedures for the management of funds, and their award and distribution. These procedures will be reviewed at a benefit committee meeting on November 30, 2007. However, the benefit committee also stated that it believes it is contradictory for the report to imply that some expenditures adhere to the explicit requirements of the law without meeting the intent of the law.

Placer County Indian Gaming Benefit Committee's Action: None.

- ➔ Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that the process in place requires applicants to describe the impact they propose to mitigate and how they will do so. However, the benefit committee indicated that during the next award cycle staff will review the descriptions in sponsored applications and provide an assessment on each application's apparent relevance to casino and gaming impacts.

San Bernardino County Indian Gaming Benefit Committee's Action: None.

The benefit committee states that it will continue to use its current application process, which includes a requirement that the applicant provide a detailed project description and information that demonstrates how the project will mitigate the effects of casinos; a procedure which does not differ from that in practice when the grants we reviewed were approved.

San Diego County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that in the next cycle of grants the application form will be amended to add a requirement that if only a small part of the project proposes to mitigate impacts related to casinos, funding for the portion of the project that provides benefits unrelated to impacts from casinos be funded from another source. However, while the benefit committee also plans to remind applicants to describe the impact on their jurisdiction and explain how their project will mitigate those impacts, this procedure does not differ materially from that in practice when the grants we reviewed were approved.

Sonoma County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it has adopted an application form that requires grant applicants to provide a complete project description, describe the impacts on their jurisdiction associated with the casino and include any data supporting the request for funds, and explain how the project will mitigate these impacts.

Finding #2: Compacts ratified since 1999 require tribes to directly fund efforts to mitigate casinos' impacts, but local governments continue to receive distribution fund money.

Post-1999 compacts require tribes to negotiate directly with local governments to pay for local mitigation projects in lieu of paying into the distribution fund. However, based on the allocation methodology established in state law in 2004, two counties where casinos under post-1999 compacts are located received roughly \$850,000 in distribution fund money in fiscal year 2005–06. Local governments in those counties received money for projects that, in accordance with the post-1999 compacts, should have been funded directly by the tribes. Consequently, less distribution fund grant money is available to other counties where tribes are not required to provide funding directly to local governments.

We recommended that the gambling commission seek changes to legislation to revise the allocation methodology outlined in the government code so that the allocation to counties is based only on the number of devices operated by tribes that do not negotiate directly with local governments to mitigate casino impacts.

Gambling Commission's Action: None.

The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Finding #3: Interest that local governments earned on unspent distribution fund money has not always gone toward mitigation projects.

Some local governments have earned interest on distribution funds until the funds are needed for an intended project. In many instances, large amounts of grant money remained unspent for more than a year, and the local governments indicated to us that the interest earned was not always allocated back to the original project or used for similar future projects. In fact, several local governments we spoke to used the interest to pay for general county operational costs. In some cases local governments did not even earn interest, instead depositing the grant funds in accounts that generate no interest.

Our legal counsel advised us that although the law does not specifically require a local government to allocate interest earned on unspent funds to original or future mitigation projects, the government code section cited by local governments states that earned interest may be deposited in their general funds unless otherwise specified by law. The purposes for which distribution fund money may be spent are set forth in the compacts and state law. Accordingly, our counsel advised us that the interest on distribution fund money is subject to the common law rule that unless it is separated by statute from the principal, the interest should be used for the originally intended purpose. Thus, we believe the interest should be used to support mitigation projects. However, several local governments asserted that the government code grants them authority to use interest earned for general purposes. Further, local officials indicated that a significant number of grants were maintained in accounts that earned no interest. Because the interest on distribution fund money is subject to the common law rule that unless it is separated by statute from the principal, the interest should be used for the originally intended purpose, we believe the interest should be used to support mitigation projects.

We recommended that the gambling commission seek changes to legislation to amend the government code to require that all funds be deposited into interest-bearing accounts, and that any interest earned is used on projects to mitigate casino impacts.

Further, we recommended that benefit committees ensure that local governments spend the interest earned on project funds only on the projects for which the grants were awarded or return the money to the county for allocation to future mitigation projects.

Gambling Commission's Action: None.

- ➔ The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which requires any jurisdiction that receives a grant from an individual tribal casino account to deposit all funds received in an interest bearing account and use the interest from those funds only for the purpose of directly mitigating an impact from a casino. This bill was referred to the committee on governmental organization on December 13, 2007.

Placer County Indian Gaming Benefit Committee's Action: None.

- ➔ Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee stated that it has sent letters to all mitigation grant recipients clarifying the need to maintain mitigation grant funds in interest bearing accounts and the required use of interest earned for casino/gaming mitigation measures.

San Bernardino County Indian Gaming Benefit Committee's Action: Corrective action taken.

The county stated that it has changed its contract language to ensure that interest earned on distribution funds for long-term capital projects will remain with the project. Material amounts of grant money for long-term projects that remain unspent will be required to be deposited into an interest bearing account. All interest earned will be allocated back to the original projects or used for future mitigation projects.

San Diego County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it will instruct applicants to either spend the interest earned on projects that mitigate impacts or return the interest to the benefit committee for allocation to future mitigation projects, if state law allows it to do so. However, the benefit committee also states that it disagrees with the bureau's interpretation of state law and that another section of the government code requires it to separate the interest from the principal and deposit it in the benefit committee's general fund.

Sonoma County Indian Gaming Benefit Committee's Action: None.

The benefit committee states that it disagrees with the recommendation and that absent changes to state law, will not change its procedures.

Finding #4: Grant allocations have generally been properly calculated, but some local governments were not awarded the amounts they were allocated through the Nexus test.

State law requires a county receiving distribution fund money to allocate a portion of its funding to local governments based on the Nexus test criteria described in the text box. In Riverside County, we identified two instances where the Nexus test criteria were not consistently applied. County officials agreed with our assessment and stated that the county would revise its application of the Nexus criteria. Further, Riverside County did not even adhere to its inaccurate Nexus test calculation. We identified several instances where cities in Riverside County were awarded less money than they should have been allocated under the Nexus test.

We recommended that benefit committees correct the inconsistent application of Nexus test criteria and ensure that local governments receive at least the minimum amounts they are allocated under the government code requirements.

Nexus Test Criteria

1. The local government jurisdiction borders Indian lands on all sides.
2. The local government partially borders Indian land.
3. The local government maintains the highway, road, or predominant access route to a casino within four miles.
4. All or a portion of the local government is located within four miles of a casino.

Riverside County Indian Gaming Benefit Committee's Action: None.

The benefit committee stated that the county has updated its information identifying how many Nexus test criteria local governments meet in order to determine what percentage share of the Nexus grant funds they are eligible to receive. However, statements in the benefit committee's response indicate that it is confused regarding the application of the formula to these corrected criteria. The committee seems to hold the mistaken impression that each local government receives a percentage of the money, rather than, as described in law and our report, each local government is entitled to an equal share of the percentage allotted to local governments meeting the same number of criteria.

Finding #5: Some grantees were not eligible for funding.

Although state law defines the intended recipients of distribution fund money—cities, counties, and special districts—some benefit committees provided grant money to ineligible entities. In two cases benefit committees awarded grants to school districts, which state law specifically excludes from the definition of special districts. Because the Legislature has identified specific entities and purposes for distribution fund grant money, counties must ensure that they follow the statutory requirements.

We recommended that benefit committees grant distribution fund money only to eligible entities.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which—for the purposes of this program—excludes school districts from the definition of “special district.” This bill was referred to the committee on governmental organization on December 13, 2007.

Fresno County Indian Gaming Benefit Committee’s Action: Pending.

The Fresno County Indian Gaming Local Community Benefit Committee (Fresno) states that it is working with staff to codify more comprehensive descriptions and procedures for the management of funds, and their award and distribution. These procedures were scheduled to be reviewed at a meeting on November 30, 2007.

Riverside County Indian Gaming Benefit Committee’s Action: None.

- ➔ The benefit committee did not address our recommendation.

Finding #6: Some benefit committee members fail to meet disclosure requirements.

The Political Reform Act of 1974 (political reform act) requires state and local officials and employees with decision-making authority to file statements of economic interests annually and on assuming or leaving a designated position. These statements are intended to identify conflicts of interest that an individual might have. However, the counties we visited could not provide 11 of the 13 statements of economic interests for tribal representatives on the benefit committees for fiscal year 2005–06.

Three of the six counties we visited informed us that the tribal members of their respective benefit committees asserted that they are exempt from the requirements to submit statements. However, the California Fair Political Practices Commission has issued an advice letter regarding this issue stating that any individual serving in a capacity as a member of a public agency, including tribal members of benefit committees, are subject to the provisions of the political reform act. The remaining three counties indicated that they do not know the reasons tribal members did not file the required statements. When designated individuals do not file statements of economic interests, benefit committees may be unaware of conflicts of interest. Further, the benefit committees cannot ensure that members are aware that they should remove themselves from making decisions that may pose conflicts of interest.

We recommend that benefit committees ensure that all benefit committee members follow the political reform act and file the required statements of economic interests, and inform the appropriate agency if they fail to do so.

Fresno County Indian Gaming Benefit Committee’s Action: None.

- ➔ The Fresno County Indian Gaming Local Community Benefit Committee (Fresno) states that in spite of the California Fair Political Practices Commission’s advice letter, it is the position of the benefit committee that as members of a sovereign nation, tribal members are exempt from the requirement.

Placer County Indian Gaming Benefit Committee’s Action: None.

- ➔ Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee’s Action: Pending.

The benefit committee states that the county is working with tribal members and anticipates resolution of this issue by October 31, 2007.

San Bernardino County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will continue to inform members of the requirement to file their statements at intervals before and after the deadline, and will notify the appropriate state agency if they do not file within two weeks of the deadline.

San Diego County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that they will remind benefit committee members to submit required statements and will inform the State of any failure by a benefit committee member to do so.

Sonoma County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee indicates that they will continue to ask all members to submit required statements of economic interests and will inform the appropriate state agency if they fail to do so.

Finding #7: Many counties did not properly report their use of distribution fund money.

State law requires each county that receives distribution fund grants to submit an annual report by October 1 each year detailing, among other information, the specific projects funded by the grants and how current-year grant money has been or will be spent. Nevertheless, many counties fail to submit the reports to all required entities. In fact, according to the gambling commission and various legislative committees, in 2006 only nine counties reported to all required entities, which include the gambling commission, the chairs of the Senate and Assembly committees on governmental organization, and the chair of the Joint Legislative Budget Committee. Furthermore, six of the 24 counties receiving funds did not report at all.

We recommended that the gambling commission seek changes to legislation to amend the government code to allocate distribution fund money only to counties that submit annual reports as required.

Further, we recommended that benefit committees submit complete annual reports to all required legislative committees and the gambling commission.

Gambling Commission's Action: None.

The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which designates any county that does not provide an annual report pursuant to the government code requirements as ineligible for funding from the distribution fund for the following year. This bill was referred to the committee on governmental organization on December 13, 2007.

Placer County Indian Gaming Benefit Committee's Action: None.

Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will provide information for grants funded in the current fiscal year in its next annual report.

Sonoma County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will submit annual reports to all required legislative committees and the gambling commission by the deadline specified in state statute.

Finding #8: New compact provisions will change the amount of revenues in the distribution and trust funds.

In June 2007 the Legislature ratified one new compact and four of five amendments to existing compacts—the fifth compact amendment was ratified after our audit. From a review of current operating information and compact terms, we estimated that the one new compact and five amendments (pending compacts) to existing compacts would significantly decrease revenues in the distribution fund and, to a lesser extent, increase Revenue Sharing Trust Fund (trust fund) revenues. We conservatively estimated that annual contributions to the trust fund from these compacts would increase by about \$6.9 million, while annual contributions to the distribution fund would decrease by \$92 million. If the revenue and expenditure levels estimated for fiscal year 2007–08 continue into the future, without additional resources the distribution fund will be unable to meet its obligations by fiscal year 2010–11, approximately four years from now. In addition to the impact on the distribution and trust funds, we estimated that contributions to the State's General Fund from these compacts would total between \$174.3 million and \$175.1 million for fiscal year 2007–08. Further, as casino operations expand, General Fund revenues will increase.

Finding #9: Post-1999 and pending compacts and amendments provide revenues to the General Fund.

Between 2003 and 2006, the Legislature ratified five new compacts and amendments to eight others (post-1999 compacts), which provided \$128 million in General Fund revenue in fiscal year 2005–06. However, that figure will increase because several casinos operating under post-1999 compacts only recently began operations or will begin operations this year. Overall, we estimated that General Fund revenues for fiscal year 2007–08 from the post-1999 and pending compacts discussed above will total between \$304 million and \$313.5 million. These amounts represent between 4.3 percent and 4.5 percent of the \$7 billion in revenue that Indian gaming in California generated during fiscal year 2004–05. Further, for fiscal year 2007–08, we estimated that trust fund and distribution fund revenue from tribal contributions will total \$39.4 million and \$47 million, respectively, representing 0.6 percent and 0.7 percent of total fiscal year 2004–05 gambling revenue, respectively.

Finding #10: General Fund revenues may be used for many purposes.

Future General Fund revenue contributions from Indian gaming may be used to help reduce the impact of the \$92 million decrease in distribution fund revenue. However, without further clarification in the government code by the Legislature, it is unclear if compact provisions that redirect a portion of their General Fund revenue contributions to the trust fund if there is an insufficient amount in the trust fund to distribute \$1.1 million to each eligible tribe take place before or after the government code requirement for the distribution fund to cover any such shortfalls in the trust fund. Furthermore, the General Fund contributions required by the compacts may also be obligated to repay a California Department of Transportation fund that made loans to the General Fund in prior fiscal years. As such, any increase in General Fund revenue from pending compacts may be obligated to repay the Transportation Congestion Relief Fund and thus would not be available for backfill distributions required by the trust fund or for other purposes.