Commission on Gambling Control Fee Proposal Assumptions and Methodology Review

May 2023

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Executive Summary

This report reviews information and assumptions included in the Gambling Control Commission (Commission) December 28, 2022 request by the Gaming Policy Advisory Committee (GPAC)—Invitation to Provide Alternative Annual Fee Calculation Methodologies. Specifically, the analysis seeks to verify information in the mock data and uses a number of reports, state budgets from various years, and other information to determine whether the mock data used by the Commission is comparable to these reference sources.

Although costs and positions in the FY 2023-24 Governor's Budget (Budget) and Salary and Wages Supplement (Supplement) are reasonably consistent when compared with the mock data used by the Commission to establish assumptions in its request for alternatives to the proposed annual fee, we are concerned that overall program costs have increased by over 25 percent in just four years.

These additional costs result in maintaining a higher level of cardroom spending than may be needed. However, stakeholders were not invited in the current exercise to provide an opinion on the necessity for specific program spending or the overall amounts spent by the state to provide regulatory oversight and enforcement, and the best avenue for addressing those concerns will likely be the state budget process.

Nevertheless, we note and question the justification for the increase in the number of special agents and associated costs supporting investigation, compliance, and enforcement actions for cardrooms, which increased from 6 agents in 2021-22 to 11 in 2022-23 and represents more than an 80 percent increase in both agents and costs. Stakeholders and the Legislature did not get a chance to review these additional costs to determine whether it warrants the fee increase to support it.

Consistent with findings from the State Auditor, reserves in the Gambling Control Fund are significantly more than necessary to operate the program. As such, the State has borrowed $45 million from the fund with an uncertain repayment schedule. The State Auditor reported that one year of expenditures may be a reasonable reserve; therefore, the adjusted reserve exceeds that amount by $25 million. Annual alignment of costs and fees appears warranted given the excess reserves that have built over time.

We also note that the FY 2023-24 Budget includes 28 authorized but unfunded licensing positions. We question the necessity of maintaining these positions in the Budget.

Given the number of unfunded positions, the increase in agent positions, and lack of details surrounding six cost pools included in the mock data, additional clarity surrounding the methodology used to assign the number of positions for all the components of the program, including licensing, enforcement, program support, cardroom support, and Third-Party Proposition Player (TPPP) support, would improve transparency of the program and the amount of fees required to support it. Additional information in the Commission report provided to the Legislature seems appropriate.

Based on this analysis, we offer several recommendations that stakeholders may want to ask the Legislature to consider.

As noted above, the Budget includes 28 authorized but unfunded positions for licensing activities. Unless there is a valid basis for retaining these positions and the fee charges necessary to maintain even unfunded positions, we recommend that the Bureau ask the Legislature to eliminate the 28 authorized but unfunded positions for FY 2023-24 and seek funding for additional positions at some point in the future should such increases be warranted.

We also note that the legislatively required January 19, 2023 Commission report falls short of requirements set by statute. We recommend that Business and Professions Code Section 19951 be amended to:

- Require the report to be submitted annually by February 1;
- Specify that all revenue types be included, not just the annual fee; and
- Clarify that the information and fiscal assumptions in the report are to be consistent with the current year's state budget and include any adjustments necessitated by the following year's budget proposed by the Governor.

Overview

This analysis evaluates whether the budget and fee allocation methodology adopted by the Commission is comparable to other publicly available data by:

- Comparing funding and personnel hours in the Commission's fee proposal with the funding and hours in the FY 2023-24 Budget and Supplement;
- Reviewing cost allocation between cardroom and TPPPs for the Commission and the Bureau in the six cost pools;
- Evaluating licensing costs and fees to determine whether they reflect the Commission's and Bureau's actual costs;
- Reviewing multiyear expenditures, revenue, and reserves in the Gambling Control Fund; and
- Determining the amount of revenue generated by the new fee proposal and discussing whether the new fees will meet, exceed, or underfund the Commission's and Bureau's costs.

This analysis evaluates a number of publicly available reports to determine whether the mock data released by the Commission on December 28, 2022, is consistent with FY 2023-24 Budget and related information. Specifically, this report compares information in the mock data with the Bureau of Gambling Control and California Gambling Control Commission's May 2019 State Audit Report and the June 9, 2021 MGT Consulting (MGT) report. In addition, this report relies on information from the Governor's Budget documents from FY 2018-19 through the recently released FY 2023-24 Budget that will be enacted in late June or early July this year. In addition, data from the Supplement, which is a companion document to the Budget, was used to review positions authorized by the Legislature for both the Commission and Bureau. To validate the number of staff in the licensing section, budget change proposals from various years were utilized.

The goal of this report is to provide greater transparency of costs and fees to the gaming industry, stakeholders, interested parties, and the California Legislature.

Budget/Cost and Personnel

This section evaluates whether the information in the mock data is consistent with information included in the FY 2023-24 Budget for both the Commission and the Bureau. A comparison of average costs for positions and total costs is utilized.

Bureau

The FY 2023-24 Budget proposes $39.851 million to support the Bureau of Gambling Control ($16.807 million Gambling Control Fund, $19.464 million Indian Gaming Special Distribution Funds, $3.58 million other funds) and an estimated 223.0 positions to support the division. Based on this information, the average cost of positions in the budget is $178,704.

The mock data reports the number of hours in a year for Bureau activities. Using 1,800 hours per year per position results in an estimate of 83.2 positions supporting the activities funded by the annual fee. The mock data represents that the annual fee collects $14.2 million to support 83.2 positions. This results in an estimated average cost per position of $170,813.

The average per-position cost in the Bureau based on the FY 2023-24 Budget is $178,704, and the mock data results in $170,813, which suggests that the two are reasonably comparable.

In addition to reviewing average per-position costs, total budgeted resources were compared to estimate the amount covered by the annual fee and the amount that might need to be funded by licensing and other fees in order to fully fund the program. The difference between the FY 2023-24 Budget of $16.807 million and the mock data of $14.200 million suggests that $2.590 million supports licensing and other activities not supported by the annual fee for cardroom and TPPPs.

Commission

The FY 2023-24 Budget proposes a total of $8.519 million ($4.777 million Gambling Control Fund and $3.742 million Indian Gaming Special Distribution Fund) and 40 positions to support state operations for Commission cardroom and TPPP operations. The Budget proposes 40 positions to support both Gambling Control Fund and Indian Gaming Special Distribution Fund workloads. In order to estimate the number of positions supported by the Gambling Control Fund, the 40 positions are prorated based on the fund split between the two funds, resulting in an estimated 22.4 positions supported by the Gambling Control Fund. Based on the Budget, the Commission's average per-position cost is $212,975.

The mock data represents that the Commission collects $3.782 million as an annual fee to support 18.6 positions, which results in average per-position cost of $203,671.

The average per-position cost for the Commission based on the FY 2023-24 Budget is $212,975, and the mock data represents a cost of $203,671, which suggests the two are reasonably comparable.

The difference between the FY 2023-24 Budget of $4.777 million and the mock data of $3.782 million would suggest that $0.995 million supports licensing activities.

In addition to reviewing average per-position costs, total revenue from the annual fee was compared to total program costs. Program costs exceed the annual fee, and the difference likely accounts for licensing and other fee revenue. The annual fee revenue is below Bureau costs by $2.590 million and Commission costs by $0.995 million, which would likely be collected from licensing and other fees.

Cost Allocation

To develop an annual fee proposal and in response to the State Auditor's recommendations, the Commission engaged MGT to develop a cost allocation methodology. The MGT report distributes costs between six cost centers split between the Commission and the Bureau and also split between cardroom and TPPPs.

MGT worked with Commission and Bureau staff to estimate how workloads should be apportioned among the six different workload categories. Each entity then estimated its respective workload split between cardrooms and TPPPs. The methodology typically broke out different assumptions between cardroom and TPPPS to determine a percentage to split estimated costs between the two entities. The assumptions included the number of active cardrooms, active TPPPs, applicants, and Commission actions.

Based on these six cost pools, the Commission proposed a fee structure that charges cardrooms and TPPPs based on a percentage of revenue.

The MGT report defined the different cost pools as identified below:

Cost Pool 1: Also known as "Even Across All," this cost allocation pool is for all non-application costs that are not directly attributed to an application fee or deposit and allocated as a cost to all TPPP business licensees and cardroom business licensees equally. This includes all costs associated with, but not limited to, administration, information technology, and legislative and regulatory workload. This describes the portion of the Commission's and the Bureau's operational costs as well as other costs that are not linked to the payment of a fee or deposit, such as the review of an application. These costs are related to the Commission's and Bureau's general work related to the oversight of the controlled gambling industry (Program Support).

Cost Pool 2: Also known as "Application Split," this cost allocation pool is for all non-application costs on a per-application basis that relate to both TPPP business licensees and cardroom business licensees that have a direct connection to the processing of applications for the controlled gambling industry and are not directly attributed to an application fee or deposit. This includes such costs associated with, but not necessarily limited to, responding to general phone calls and the processing of electronic and regular mail. This describes costs generally associated with the processing of applications but cannot be directly linked to the fee or deposit associated with the review of an application (General Licensing Costs).

Cost Pool 3: Also known as "Entity Split," this cost allocation pool is for all non-application costs generated by non-Commission actions that relate to both TPPP business licensees and cardroom business licensees. This includes costs associated with, but not necessarily limited to, compliance and enforcement, financial audits, calls for service, and incident reports borne separately by TPPP business licensees and cardroom business licensees (Audit and Enforcement).

Cost Pool 4: Also known as "Commission Actions," this cost allocation pool is for all non-application costs generated by matters requiring Commission action that relate to TPPP business licensees or cardroom business licensees. This includes such costs associated with, but not necessarily limited to, administrative hearings and decisions and Commission meetings (Commission Actions).

Cost Pool 5: Also known as "Cardroom Only," this cost allocation pool is for all non-application costs that are specific to cardroom business licensees but not directly linked to a Commission approval. This includes, but may not be limited to, compliance reviews of games, reviews of reports, and local ordinance reviews (Cardroom).

Cost Pool 6: Also known as "TPPPs Only," this cost allocation pool is for all non-application costs that are specific to TPPP business licensees but not directly linked to a Commission approval. This includes, but may not be limited to, contract renewal notices and non-investigation industry inquiries or correspondence (TPPPs).

Table 1 summarizes the costs associated with each pool and how they are broken out between the Commission and Bureau. In addition, the costs are broken out between cardrooms and TPPPs.

Table 1

Cost Allocation Summary ($ in millions)	Cost Pool 1	Cost Pool 2	Cost Pool 3	Cost Pool 4	Cost Pool 5	Cost Pool 6	Total
	Program Support	Licensing	Audit Enforcement	Commission Actions	Cardroom non-license	TPPS non-license	
Commission	$ 1.636	$ -	$ -	$ 1.000	$ 0.699	$ 0.447	$ 3.782
Bureau	$ 2.364	$ 2.000	$ 8.000	$ -	$ 0.301	$ 1.553	$ 14.218
Totals	$ 4.000	$ 2.000	$ 8.000	$ 1.000	$ 1.000	$ 2.000	$ 18.000
Cardroom	$ 2.000	$ 0.415	$ 5.818	$ 0.333	$ 1.000	$ -	$ 9.566
TPPPS	$ 2.000	$ 1.585	$ 2.182	$ 0.667	$ -	$ 2.000	$ 8.434
Totals	$ 4.000	$ 2.000	$ 8.000	$ 1.000	$ 1.000	$ 2.000	$ 18.000

Overall, the proposed cost allocation methodology makes sense; however, we make several observations regarding various details in the proposal.

First, the level of detail in the different cost pools could not be substantiated with information contained in the Budget. The Budget is at a higher level of detail, and therefore, we were unable to verify the lower level of detail in the cost allocation strategy. While the Budget lacks detail supporting the lower-level specificity, the $18.0 million contained within the cost allocation strategy is in line with the overall context of Budget totals.

Second, the cost split between the Commission and Bureau is consistent with the two different entities displayed in the 2023-24 Budget.

Third, the State Auditor raised concerns about the ability of the Bureau and the Commission to track hours with the existing licensing information system. Because of the limitations of the existing system, the cardroom and TPPP split is based on various assumptions rather than on actual hours worked. The Bureau is in the process of replacing the outdated licensing information system, and data supporting the six cost pools will likely be improved when the new system is implemented.

Overall, the approach with the six cost centers split between the Bureau and Commission as well as the cardroom and TPPPs seems reasonable given the data limitations and will likely improve as the program matures and additional workload data is available once replacement of the licensing system is completed.

One additional point regarding the cost allocation is related to licensing costs. Cost Pool 2 identifies $2.0 million that appears to be the costs of licensing staff not directly supported by licensing fees. According to MGT, most of the work of the licensing section can be billed to a specific background investigation; however, there are some required tasks that are not specific to an applicant. These tasks include the oversight of staff by management, administrative tasks, ordinance review, and transactional review. This cost pool is discussed in the licensing section below.

Licensing Costs and Fees (Non-annual Fee)

This section evaluates whether the new licensing and other fees are in line with licensing costs by reviewing:

- Information contained in the State Auditor report;
- Information contained in various Bureau budget change proposals for cardroom and TPPP workload for the Bureau; and
- Licensing fee revenue included in the MGT report.

According to the State Auditor's May 2019 report regarding the Bureau of Gambling Control and California Gambling Control Commission;

> In possible violation of state law, the regulatory fees that the commission and bureau charge applicants, cardroom 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 non-licensing regulatory fees that cardroom owners and third-party company owners pay far exceed the costs of the related oversight.[1]

"In fiscal year 2017-18 the Gambling Fund received $4.2 million from application fees and background deposits. In the same year, we estimated that the Bureau spent $9.3 million on licensing personnel and related operating expenditures,

[1] Bureau of Gambling Control and California Gambling Control Commission, May 2019, California State Auditor Report, page 31

while the commission spent $580,000. This combined total of $9.9 million in licensing expenditures exceeded fee revenue by $5.7 million."[2]

In its April 19, 2019 response to the audit report, the Bureau did not take issue with this item.

Since 2015-16, there have been several budget change proposals (BCP) addressing the number of licensing staff in the Bureau. The information below summarizes the funding history of the program since 2015-16, which is also summarized in Table 2.

Legislative Authorized and Funded Position History

- 2015-16—Included twenty historical baseline licensing positions.
- 2015-16—Added 12 limited-term positions with three-year limited-term funding for a total of 32 positions funded.
- 2016-17—Added an additional 20 limited-term positions, for a total of 52 authorized and funded positions through a Legislative augmentation
- 2019-20—Established 32 permanent positions (12 limited-term positions from 2015-16 and 20 limited-term positions from 2016-17). Total authorized positions was then at 52. Although the positions were permanent, funding was only for two years.
- 2021-22—Established six new permanent positions, bringing total authorized licensing positions to 58. Limited-term funding supports 26 positions, plus baseline funding for 20 positions supports only 46 of the 58 positions.
- 2023-24—Proposed funding for ten existing positions plus 20 baseline positions, bringing total funding to 30 positions. Of the 58 authorized positions, 28 are unfunded.

As Table 2 indicates, there are 58 authorized positions for FY 2023-24, but funding only supports 30 of them. The Legislature may want to consider eliminating the 28 authorized but unfunded positions.

Licensing costs and revenue are not clearly broken out in the reference material, so a rough order of magnitude was used to determine whether costs and revenue are reasonably accounted for in the Budget. Information was evaluated from several sources to present an estimate of licensing costs and revenue.

[2] *Id.* at page 33

Table 2

Authorized Positions	2019-20	2020-21	2021-22	2022-23	2023-24
Base line positions	20	20	20	20	20
BCP Positions 2019-20	32	32	32	32	32
BCP Positions 2021-22			6	6	6
Total Authorized Positions	52	52	58	58	58
Funded Positions					
Baseline Positions	20	20	20	20	20
BCP 2019-20	32	32			
BCP 2021-22			26	26	
BCP 2023-24					10
Total Funded Positions	52	52	46	46	30

With regard to the licensing costs for the Bureau, since data is limited, one approach for determining program costs would be to use marginal costs in BCPs in order to extrapolate across base positions and estimate total costs. The 2023-24 BCP for licensing staff totals $1.300 million for ten positions, resulting in a marginal cost of $130K per position. Applying this cost to the ten positions in the BCP and estimating the costs for the 20 baseline positions results in a licensing cost estimate of $3.9 million for the Bureau. This likely underestimates the licensing costs because the average costs for positions in the Bureau are $178K per position. Using this higher figure might overestimate the cost because licensing positions are typically lower-cost analytical or technical positions. However, for a rough order of magnitude, this analysis utilized $3.9 million for Bureau licensing costs.

For the Commission, there are no recent BCPs to estimate costs, and although licensing costs are presented in the Supplement, there is no way to break out the costs from those for staff who support Indian Gaming. Previously, we evaluated the 2023-24 Budget and the mock data to estimate costs recovered by the annual fee and other costs borne by the Gambling Control Fund. The difference between the 2023-24 Budget of $4.777 million and the mock data of $3.782 million would suggest that $0.995 million might support licensing costs.

Taken together, the Bureau and Commission costs result in estimated total licensing costs of $4.895 million.

Similarly, there is no clear information regarding licensing revenue and whether revenue is reasonably expected to pay for program costs. Licensing revenue comes from over 25 different fees charged by the Commission. This includes initial license fees and annual renewals, background deposits, fingerprint charges, and other fees. These charges represent all fees collected except the annual fee.

One component of revenue information is presented in Cost Pool 2. As noted above, Cost Pool 2 is a cost allocation for all non-application costs on a per-application basis that relate to both TPPP business licensees and cardroom business licensees that have a direct connection to the processing of applications for the controlled gambling industry and are not directly attributed to an application fee or deposit. Cost Pool 2 Bureau costs funded by the annual fee are $2 million.

In addition to Cost Pool 2, the only data that might allow estimates of other licensing revenue is contained in Section 6 of the MGT report, which includes a table from 2019-20 that reports total licensing, deposits, and other fees based on the new fees. Adding all revenue in the table and removing the annual fee revenue results in $2.840 million in revenue from licensing fees, deposits, and other fees. This calculation may under- or overestimate the revenue; however, there does not appear to be a better estimate.

Taken together, the $2 million from the annual fee and the $2.840 million revenue from the MGT report would add up to $4.840 million in fees that support licensing and other functions.

The estimated licensing costs of $4.895 million are reasonably comparable to the estimated licensing revenue of $4.840 million.

Multiyear Expenditures, Revenue, and Reserves

This section provides a summary review of expenditures, revenue, and reserves for a multiyear period. Based on information contained in the budgets from FY 2018-19 to FY 2023-24 (six years), the information below summarizes expenditures, revenue, and reserves (see Table 3 and Figure 1). There are several noteworthy observations regarding General Fund loans and payments, fluctuations in revenue, and total costs from the Gambling Control Fund. In addition, Table 3 and Figure 1 include an adjustment to reserves to reflect an outstanding loan balance.

As noted above, during this six-year period there were several General Fund loan repayments and a significant General Fund loan. The repayments totaled $29 million in FY 2019-20 that significantly increased reserves. A General Fund loan of $85 million was initiated in FY 2020-21, offsetting gains from the prior General Fund loan repayments. However, subsequent to the $85 million loan, The 2021-22 Budget identifies a loan repayment of $40 million leaving an outstanding balance of $45 million. This loan is currently outstanding, and it is unclear when the loan will be repaid. When considering the outstanding loan, FY 2023-24 ends the year with over $50 million in reserves.

The State Auditor indicated that a two-month reserve would likely be too small and recommended a reserve of up to one year.[3] Given the total expenditures of $25 million for FY 2023-24 and the adjusted reserves at $50 million, the reserve is $25 million more than necessary.

We also note that annual revenue fluctuated over the six-year period. More specifically, revenue exceeded $20 million in four of the years but was only $7.6 million in FY 2020-21 and $10.7 million in FY 2021-22. This is likely attributable to the significant fee reductions provided by the Commission during the COVID 19 pandemic.

We are concerned about the significant cost increases to the program. Expenditures during this same time period range from a low of $19.960 million in 2021-22 to a proposed $25.202 million for 2023-24. This represents more than a 25 percent increase in four years.

Finally, a technical adjustment has been proposed: moving $6.005 million from the Gambling Control Fund that should have been deposited in the Indian Gaming

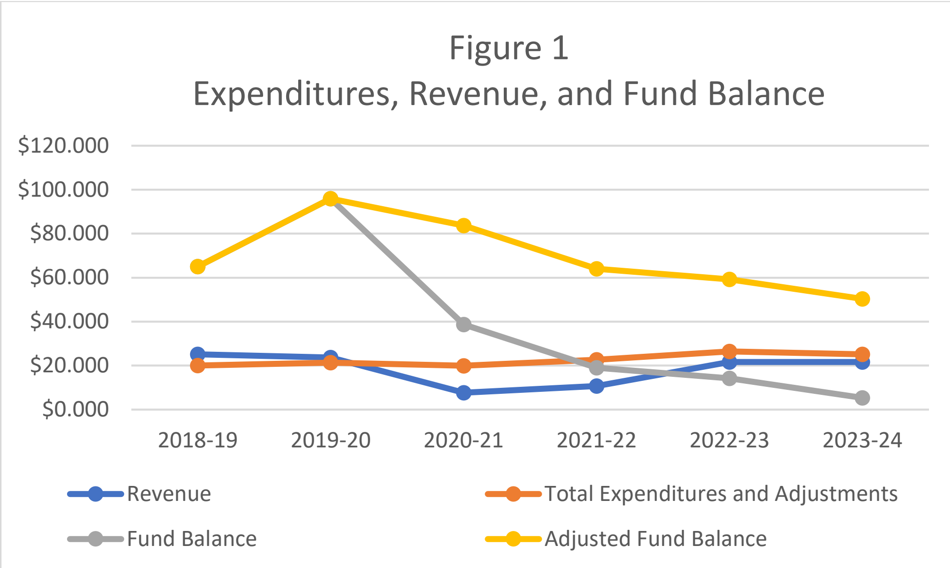
[3] *Id.* at page 36.

Special Distribution Fund. A BCP moving these funds for FY 2023-24 has been submitted for consideration by the Legislature.

Table 3

Expenditures, Revenue and Reserves						
($ in millions)	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Beginning Balance	$60.753	$64.992	$95.912	$38.720	$19.057	$14.224
Prior Year Adjustment	-$0.811	-$0.313		-$6.049		
Adjusted Beginning Balance	$59.942	$64.679	$95.912	$32.671	$19.057	$14.224
Revenue	$ 25.134	$23.659	$7.684	$10.702	$21.620	$21.620
Loan Repayment		$29.000	$40.000			$0.708
Loan			-$85.000	-$1.612		
Other adjustments						-$6.005
Total Revenue	$25.134	$52.659	-$37.316	$9.090	$21.620	$16.323
Total Resources	$85.076	$117.338	$58.596	$41.761	$40.677	$30.547
Department of Justice	$14.942	$15.959	$14.761	$17.337	$20.037	$17.955
Commission	$3.502	$3.767	$3.436	$4.083	$4.779	$4.777
Fi$Cal	$0.002	-$0.002				
Pension Payments	$0.183	$0.402	$0.402	$0.402	$0.402	$0.402
Statewide Admin Costs	$1.455	$1.300	$1.361	$0.882	$1.235	$2.068
Total Expenditures and Adjustments	$20.084	$21.426	$19.960	$22.704	$26.453	$25.202
Fund Balance	$64.992	$95.912	$38.636	$19.057	$14.224	$5.345
Outstanding Loan			$45.000	$45.000	$45.000	$45.000
Adjusted Fund Balance	$64.992	$95.912	$83.636	$64.057	$59.224	$50.345

Figure 1 summarizes Table 3 and graphically depicts expenditures, revenue, reserves (fund balance), and adjusted reserves for the six-year period based on budget data. For the past several years, expenditures have exceeded revenue, as demonstrated by the downward slope of the “adjusted fund balance” line (gold) in the graph.



Do Fees Meet, Exceed, or Underfund Actual Costs?

This section quantifies FY 2023-24 costs and fees to determine whether fees meet, exceed, or underfund costs. Table 4 summarizes FY 2023-24 as it relates to revenue from fees and expenditures. The reported expenditures are from the FY 2023-24 Budget of $25.002 million. Revenue information was estimated based on the MGT report and the mock data, totaling $20.8 million. This results in expenditures exceeding revenue by approximately $4.4 million. The budget assumes the $4.4 million will be paid by reserves.

It is important to note that there may be some savings generated by vacancies that would mitigate the difference between expenditures and revenue. If the Commission and Bureau were to experience 5 percent vacancies—which is not uncommon for a state agency—that would result in 5 percent savings, which could generate up to $1.25 million in savings, potentially reducing the amount expected to be paid by the reserve to $3.15 million.

Although expenditures exceed revenue for FY2023-24, reserves are more than sufficient to pay these additional costs in the near term. However, reviewing expenditures and revenue annually and aligning fees appropriately will allow the Commission and Bureau to ensure reserves are not unreasonably excessive or insufficient to appropriately fund the program.

Table 4

2023-24 Proposed Budget	
($ in millions)	Total
Commission	$ 4.777
Bureau	$ 16.807
Other DOJ Costs	$ 1.148
Supplemental Pension Payments	$ 0.402
Pro Rata	$ 2.068
Total State Operations Costs	$ 25.202
Revenue	
Annual Fee Revenue	$ 18.000
Licensing Revenue	$ 2.800
Total Revenue	$ 20.800
Difference (Costs Exceed Revenue)	**$ 4.402**

Commission January 19, 2023 Report to the Legislature

On January 19, 2023, the Commission submitted a report to the Legislature related to Gambling Control Fund costs and fees, as required by law. Business and Professions (B&P) Code Section 19951, among other things, provides the authority for the Commission to establish fees by regulations and requires a report to be submitted to the Legislature every other year, beginning January 1, 2023. B&P Section 19951(f)(1) outlines the contents of the report and specifies "detailing the fee levels established by the commission through regulations."

The Commission's January 19, 2023 report falls short of meeting the requirements established by the Legislature insofar as it does not include licensing and other fees. Specifically, the report focuses only on the annual fee and omits licensing and other fees established by regulation by the Commission. Based on the information provided, it is impossible to determine the total revenue from all the fees established by the Commission through regulations.

We recommend that the Legislature consider amending B&P Section 19951 to clarify that the report is to be submitted annually, that it is to include all fee types, and that it is to represent both costs and revenue included in the January budget.

Specifically, we recommend the following amendments:

19951(f)(1): Beginning January 1, 2023, and ~~every two years~~ *every year* thereafter *by February 1*, the commission shall provide a report to the appropriate budget and policy committees of the Legislature detailing the *annual, licensing and other* fee levels established by the commission through regulations. *The report shall be consistent with budgeted costs and anticipated revenue for the commission and the Department of Justice presented in the January 10th Governor's Budget.*

(2) The report required by this subdivision shall describe how fees for each licensing category were calculated, including how licensee gross revenues and state regulatory costs were used in the calculation. If a workload-based methodology is used to establish fees, the commission shall include in its report a breakdown of the personnel cost, operating cost, and overhead cost figures used to determine fee levels.

Gambling Control Fund and Indian Gaming Special Distribution Fund

Overall, the Department of Justice budget is complex due to the number of funding sources, different units or sections, and employees. Specifically, there are 33 unique funds with over 100 different work units and over 5,800 employees. The FY 2023-24 Budget totals over $1.2 billion among all of the funds.

The Department utilizes a legacy accounting system to manage the payments for payroll and other costs. Sections may be split-funded or have a single funding source. When a program is split-funded, payroll for the unit would be composed of several funding sources and allocated by the proportional amount of each funding source, not the type of work each employee does. The Bureau has had a difficult time managing workload in accordance with the cost allocation, which is discussed in more detail below.

Program support and administrative function costs, such as budgets, human resources, and the legislative unit, are distributed across all programs and funds. However, leadership for a particular division is only supported by the funds that support that division. For example, leadership for the Division of Law Enforcement is prorated across all funds supporting law enforcement activities.

More than likely, staff and activities supporting cardroom and TPPPs are funded by a single funding source: the Gambling Control Fund. Likewise, activities supporting Indian Gaming are funded from the Indian Gaming Special Distribution Fund.

Even though staff supporting different activities are funded from different sources, program management is not able to manage workload to align with expectations based on the funding source. According to the State Auditor;

> 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 cardroom-related activities. Although we also noticed instances when employees funded from the Gambling [Control] 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 cardroom-related enforcement work over the last three years.[4]

In addition to difficulty managing workload among the two funds, we also know that these funds have subsidized General Fund work. For FY 2023-24, the Bureau has submitted a BCP to refund the Indian Gaming Special Distribution Fund and the Gambling Control Fund for illegal gambling enforcement activities that should have been paid by the General Fund.

According to another report from the State auditor, "The Bureau has also continued to charge the distribution fund for nontribal activities, although we were unable to identify the extent of these incorrect charges. For fiscal years 2018-19 through 2020-21, the Bureau's tribal employees charged more than 2,200 hours of card-room enforcement activities to the distribution fund, as well as a smaller number of hours for activities such as providing protective services for the Office of the Attorney General (Attorney General) and assisting the Bureau of Firearms with investigations. However, the total number of inappropriately charged hours is unclear because tribal employees also charged large portions of their time—a collective 26 percent—under a broad and vague category called general law enforcement." [5]

The State Auditor also said, "Given the ongoing nature of this problem, a more effective safeguard against improper timekeeping charges would be for the Bureau to update its timekeeping software to prevent employees from being able to charge the distribution fund for nontribal activities. However, the assistant director stated that the Bureau cannot make such an update to its current

[4] *Id.* at page 55.
[5] Indian Gaming Special Distribution Fund, August 2022, California State Auditor Report, pages 18, 19.

timekeeping system. He indicated that the Bureau is pursuing new timekeeping software and plans to roll out the new system in January 2025."

Based on the State Auditor reports and the BCP refunding the Indian Gaming Special Distribution Fund and the Gambling Control Fund for General Fund enforcement activities, the Bureau continues to struggle with aligning staff and workload with the correct funding source.

Enforcement

The mock data in Cost Pool 3 includes information on Bureau auditing and enforcement activities. Based on the number of hours, there are approximately 48 employees who attribute time to these activities, and costs are reported at $8 million. The data indicates there are 10 auditors, 11 special agents, 5 field representatives, and 4 investigative auditors, and a number of other staff who support these activities.

In order to determine the cost allocation for enforcement activities between cardrooms and TPPPs, the mock data used 80 active cardrooms and 30 active TPPPs to determine a 73 percent and 27 percent funding split, respectively.

As noted above, the State Auditor raised significant issues with the way the Bureau manages the Indian Gaming Special Distribution Fund and Gambling Control Fund costs specifically related to enforcement activities. The audit report indicates that the issues are likely not going to be resolved until the Bureau implements a new licensing system for the Bureau, which is not expected to be completed until 2025.

Other factors that lead to growing concerns regarding enforcement costs include discrepancies between enforcement costs in the MGT report and those in the mock data as well as a significant increase in special agents. The MGT report identifies enforcement costs in Cost Pool 3 at $3.3 million; however, the mock data represents this cost as $8 million. It is unclear what led to this significant discrepancy. Additionally, we note concerns regarding the increase in the number of special agents and associated costs supporting enforcement actions for cardrooms, which has increased from 6 agents in 2021-22 to 11 in 2022-23, representing more than an 80 percent increase in agents and costs. Stakeholders and the Legislature did not get a chance to review these additional costs to determine whether it warrants the fee increase to support it.

Revenue

Although there is limited data available quantifying all of the revenue changes as a result of the new fees, we make several observations as it relates to license fees, deposits and other fees as well as the new fees proposed for the cardrooms.

As noted in the licensing section, the MGT report includes a table from 2019-20 that reports total licensing, deposits and other fees based on the historical and new fees. Adding all revenue in the table and removing the annual fee revenue results in $2.840 million in revenue from the new licensing fees, deposits, and other fees. Making this same calculation with the historical data results in $4.720 million in revenue from the licensing fees, deposits, and other fees. This results in a reduction of $1.879 million from the historical licensing fees, deposits and other fees to the new fees.

We also reviewed the historical table fees paid by cardrooms compared to the new proposed fees based on the mock data. Based on the review, the revenue generated from the historical table fees would result in an estimated $7.078 million while the new cardroom fees will generate $9.567 million. This represents an increase of $2.488 million which is a 35 percent increase.

Conclusion

This report reviews the information and assumptions included in the Gambling Control Commission (Commission) December 28, 2022 request by the Gaming Policy Advisory Committee (GPAC)—Invitation to Provide Alternative Annual Fee Calculation Methodologies. Specifically, the analysis seeks to verify information in the mock data and uses a number of reports, state budgets from various years, and other information to determine whether the mock data used by the Commission is comparable to these reference sources.

Although costs and positions in the FY 2023-24 Budget and Supplement are reasonably consistent when compared with the mock data used by the Commission to establish assumptions in its request for alternatives to the proposed annual fee, we are concerned that overall program costs have increased by over 25 percent in just four years.

These additional costs result in maintaining a higher level of cardroom spending than may be needed. However, stakeholders were not invited in the current exercise to provide an opinion on the necessity for specific program spending or the overall amounts spent by the state to provide regulatory oversight and enforcement, and the best avenue for addressing those concerns will likely be the state budget process.

Nevertheless, we note and question the justification for the increase in the number of special agents and associated costs supporting investigation, compliance, and enforcement actions for cardrooms, which increased from 6 agents in 2021-22 to 11 in 2022-23 and represents more than an 80 percent increase in both agents and costs. Stakeholders and the Legislature did not get a chance to review these additional costs to determine whether it warrants the fee increase to support it.

Although specific data supporting cost allocation among six cost pools is not available, cost allocation appears reasonable in the context of the overall budget. The Bureau is in the process of replacing its outdated licensing information system, and data supporting the six cost pools should be improved with the new system.

Comparing estimated licensing costs to estimated licensing and annual revenue suggests fees are likely aligned with costs. However, the FY 2023-24 Budget includes 28 authorized but unfunded positions for Bureau licensing activities. We question the need for maintaining these positions in the Budget.

Consistent with findings from the State Auditor, reserves in the Gambling Control Fund are significantly more than necessary to operate the program. As such, the State has borrowed $45 million from the fund with an uncertain repayment schedule. Adjusting reserves to reflect the outstanding loan results in $50 million which significantly exceeds annual expenditures of only $25 million and are excessive. The State Auditor reported that one year of expenditures may be a reasonable reserve; therefore, the adjusted reserve exceeds that amount by $25 million.

For FY 2023-24, overall expenditures are proposed to exceed revenue by $4.4 million and are anticipated to be paid by reserves. Although reserves are sufficient to pay these costs in the near-term, annual alignment of costs and fees appears warranted given the excess reserves that have built over time.

Given the number of unfunded positions, the increase in agent positions, and lack of details surrounding the six cost pools, additional clarity surrounding the methodology used to assign the number of positions for all the components of the program, including licensing, enforcement, program support, cardroom support, and TPPP support, would improve transparency of the program and the amount of fees required to support it. Additional information in the Commission report provided to the Legislature seems appropriate.

Based on this analysis, we offer several recommendations that stakeholders may want to ask the Legislature to consider.

As noted above, the Budget includes 28 authorized but unfunded positions for licensing activities. Unless there is a valid basis for retaining these positions and the fee charges necessary to maintain even unfunded positions, we recommend that the Bureau ask the Legislature to eliminate the 28 authorized but unfunded positions for FY 2023-24 and seek funding for additional positions at some point in the future should such increases be warranted.

We also note that the legislatively required January 19, 2023 Commission report falls short of requirements set by statute. We recommend that Business and Professions Code Section 19951 be amended to:

- Require the report to be submitted annually by February 1;
- Specify that all revenue types be included, not just the annual fee; and
- Clarify that the information and fiscal assumptions in the report are to be consistent with the current year's state budget and include any adjustments necessitated by the following year's budget proposed by the Governor.

Jim Lombard Bio January 2023

Jim has over three decades of experience working for the State of California in executive leadership positions and is currently working as a Senior Management Consultant assisting the California Department of Transportation, Information Technology Division and initiating a public and private sector consulting firm, Streamline Strategies.

For two decades, Jim's executive leadership experience included working for the State Controller's Office, Department of Justice, and Covered California among others. At the State Controller's Office, Jim was part of a team that assisted in managing the State's $6 billion cash shortfall to avoid default on critical constitutionally mandated payments during the great recession. He also oversaw statewide payroll for approximately 160,000 state employees and disbursement of state funds of approximately $800 billion annually. At the Department of Justice, he worked with the Department of Finance and the Legislature to implement Proposition 69 approved by the voters to collect DNA samples from convicted felons. Jim also oversaw the transition of Covered California from $1 billion Federal Funds to premiums paid by policy holders to implement the Affordable Care Act in California. These leadership positions typically included oversight of budgets, accounting, information technology, human resources, and facilities. He also led strategic and tactical planning for several of these agencies.

During this time, Jim served on several State boards and steering committees. He spent seven years as an executive sponsor and steering committee member for two enterprise resource planning projects, one effort to replace the State's legacy statewide payroll system (21st Century Project) and the successful replacement of the State's legacy statewide accounting and budget system (Fi$Cal) respectively. Jim also represented the State Controller on the State Public Works Board and the Technology Services Board. Most recently Jim served on the California Residential Mitigation Program Board at the California Earthquake Authority.

These duties were performed through the following:

- Chief Administrative Officer, California Earthquake Authority, August 2020 to September 2022
- Chief Deputy Court Executive Officer, Sacramento Superior Court, October 2017 to August 2020
- Chief Financial Officer, Covered California, July 2014 to October 2017
- Chief Administrative Officer, State Controller's Office, April 2007 to July 2014
- Assistant Director of Administrative Services, California Department of Justice, September 2003 to April 2007

Jim also has ten years of experience (1993 to 2003) with the State of California Department of Finance preparing, enacting, and administering the Governor's Budget for various State agencies and departments. He was responsible for state operations budgets, including but not limited to, Department of Food and Agriculture, Horse Racing Board, Legislature, Department of Justice, Secretary of State, and various programs in Department of Corrections and Rehabilitation. He also served in the capital outlay unit overseeing property acquisitions and construction projects for various state entities including Resources Agency programs, Environmental Protection, Health and Human Services, and Department of Veterans Affairs. He managed preparation of the State's $54 billion Five-Year Capital Infrastructure plan used by the Governor and Legislature to establish infrastructure funding priorities for the State. As a principal at Finance, duties included preparing budgets, testifying at legislative budget sub-committees and budget conference committee, as well as analyzing legislation for fiscal and policy considerations.

Jim has a Bachelor of Science in Chemistry from Cal Poly San Luis Obispo.

Jim is married to Lisa, has three daughters and two grandchildren. When not working, Jim spends his time with family and outside hiking, bicycling and fly fishing.

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