

# Arizona Department of Gaming

Department assesses compliance with Tribal-State Gaming Compact, but should enhance its gaming facility employee recertification and horse racing licensure processes

Performance Audit and  
Sunset Review

August 2018  
Report 18-105

A Report to the Arizona Legislature

Lindsey Perry  
Auditor General





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August 21, 2018

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Mr. Daniel Bergin, Director  
Arizona Department of Gaming

Transmitted herewith is a report of the Auditor General, *A Performance Audit and Sunset Review of the Arizona Department of Gaming*. This report is in response to a September 14, 2016, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona Department of Gaming agrees with all of the findings and plans to implement all of the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Lindsey Perry, CPA, CFE  
Auditor General

Attachment



## Arizona Department of Gaming

**CONCLUSION:** The Arizona Department of Gaming (Department) regulates and monitors tribal gaming in the State. Tribal gaming in Arizona is governed by a formal agreement, or Compact, negotiated between the State and participating tribes. We found that the Department has developed various processes to help ensure compliance with the Compact, including verifying that tribes appropriately contribute monies to the State. We also found that the Department appropriately certified tribal gaming facility vendors and employees reviewed, but it should continue to enhance the tribal gaming facility employee recertification process by performing required financial background checks. The Department is also responsible for regulating and overseeing pari-mutuel horse racing and wagering in Arizona, including licensing horse-racing participants. We found that although the Department appropriately issued racing licenses reviewed, it should improve its background investigation process, enhance supervisory review of licensing decisions, and formalize its process for conducting licensing interviews.

### Department is responsible for overseeing tribal gaming in Arizona

The Department is responsible for regulating and overseeing tribal gaming in the State and has established several practices for doing so. For example, the Department conducts Compact Compliance Reviews (CCRs) and follows up on these reviews to assess tribal gaming facilities' compliance with the Compact and help ensure any noncompliance is addressed. We observed a CCR in November 2017 and found that the Department adhered to its CCR process and audit plan for the areas observed. In addition, we reviewed reports from 11 CCRs completed in 2016 and 2017 and found that the Department adhered to its follow-up process and that tribal gaming facilities had resolved, or were in the process of resolving, all violations. We also found that the Department has established controls to verify that tribes are contributing the appropriate amount of gaming monies to the State and local governments, as required by the Compact.

### Department appropriately certified gaming vendors and employees reviewed, but should continue to enhance employee recertification process

**Department appropriately certified vendors reviewed**—The Compact requires that vendors who do business with tribal gaming facilities, such as gaming device manufacturers and distributors, be certified by the Department. Vendor applicants must submit several items to the Department to qualify for certification, such as application forms, the required certification fee, fingerprint cards for company executives, financial statements that demonstrate evidence of no tax liability, and organizational charts. Vendors must renew their certification every 2 years. We reviewed a sample of 10 vendor certifications and 5 vendor certification renewals issued in fiscal year 2017 and found that the Department appropriately certified and renewed certification for the vendors reviewed.

**Department needs to perform required expanded financial background checks when recertifying some employees**—The Compact also requires the Department to certify gaming facility employees such as dealers, floor managers, and casino managers. To be certified, applicants must comply with various requirements, such as submitting a fingerprint card and current photograph, as well as passing the Department's background investigation. Employee certifications must be renewed annually, and department policy indicates that employees in certain management positions, such as casino managers and finance directors, undergo an expanded financial background check at least once every 2 years to renew their certification. We reviewed a random sample of 15 initial certifications submitted during fiscal year 2017 and found that the Department appropriately reviewed the certification applications and issued certifications to qualified applicants. However, based on our review of 15 renewal applications submitted during fiscal year 2017, we found that the Department did not perform the required expanded financial background check when renewing the certification for three individuals in gaming-management positions. During the audit, the Department began taking steps to help ensure that the appropriate gaming-management employees undergo an expanded financial background check. For example, the Department began developing a reference guide to clearly identify all gaming-management employees.

## Recommendation

The Department should continue its efforts to properly identify and classify all gaming-management employees to ensure they receive the required expanded financial background checks during the recertification process and incorporate the changes it has made in its policies and procedures, and then train staff accordingly.

## Department should enhance horse racing licensure process to better ensure it appropriately issues licenses in a timely manner

**Department appropriately processed and issued racing licenses reviewed**—To be licensed, applicants must complete a licensing application form, pay the required licensing fees, and submit two sets of fingerprint cards. Statute then allows the Department to issue temporary licenses to applicants who meet a portion of the initial licensing requirements, allowing them to work at a racetrack the same day they apply. Issuing temporary licenses to applicants who participate in horse racing events is a racing industry practice, and the Department issues temporary 90-day racing licenses to qualified applicants. We reviewed a random sample of 30 licenses that the Department issued between July 2015 and June 2017, and found that it appropriately reviewed, processed, and issued all 30 licenses, including completing an initial background check and then submitting the fingerprint cards to the Arizona Department of Public Safety (DPS) and the Federal Bureau of Investigation (FBI) for criminal history records checks.

**Department should improve some horse racing licensing practices**—The Department is required to process and review fingerprint criminal history records checks before temporary racing licenses become permanent. However, based on our review of the 30 licenses, the Department did not receive criminal history information from the DPS and the FBI for two licenses because the fingerprints were unreadable. Due to the manual nature of work in the horse racing industry, applicants' fingerprints may wear at an increased rate, thereby making the fingerprints unusable for performing fingerprint-based criminal history records checks. When fingerprints are unreadable, it is the Department's responsibility to demonstrate due diligence in performing a criminal history records check by using all options available. Therefore, the Department should perform name-based criminal history records checks through the FBI when fingerprint-based checks are unable to be performed.

In addition, the Department is required to review the results of criminal history records checks within 90 days of the initial application for licensure, and our review of department records indicated that 44 of the 1,154 licenses processed from August 2017 through March 2018 took longer than 90 days. The Department reported it was not able to complete all the background investigations in a timely manner during this time frame because a staff member was unavailable. Therefore, the Department should cross-train its licensing staff to ensure that there are additional staff trained to complete background investigations and make licensing recommendations and decisions.

Finally, although the Department has developed a policy that requires department staff to interview applicants for certain license types to ensure they are qualified for licensure, such as jockeys who have not ridden a horse in 12 months, it has not developed any guidance for department staff on the information that should be obtained through the interview to demonstrate the applicant is qualified for licensure. Therefore, the Department should develop and implement policies and procedures for conducting interviews, such as what information should be obtained through an interview, to ensure that licensing applicants are evaluated consistently and effectively.

## Recommendations

The Department should:

- Perform name-based background checks through the FBI when fingerprint-based background checks are unable to be performed;
- Cross-train its licensing staff to complete criminal background investigations and make licensing recommendations; and
- Develop and implement policies and procedures for conducting licensing interviews, such as what information should be obtained through an interview.



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## Audit scope and objectives

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona Department of Gaming (Department) pursuant to a September 14, 2016, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq. This audit addresses the Department's regulation and enforcement of the Tribal-State Gaming Compact (Compact) and the licensing of horse racing participants, such as jockeys and horse owners. It also includes responses to the statutory sunset factors specified in A.R.S. §41-2954.

## Department history

The Department was established in 1995 to regulate and monitor tribal gaming for the State of Arizona. Tribal gaming in Arizona is governed by a formal agreement, or Compact, which is negotiated between the State and participating tribes (see textbox). As of May 2018, there were 16 tribes operating 24 class III gaming facilities in the State (see Figure 1 on page 2).<sup>1</sup> Another 6 tribes in the State do not have gaming facilities but have slot machine rights that they may lease to other tribes. In 2015, the Legislature consolidated the Arizona Department of Racing within the Department, which expanded the Department's responsibilities, including the regulation of pari-mutuel horse racing and wagering, and providing staff support to the Arizona State Boxing and Mixed Martial Arts Commission (Boxing and MMA Commission).<sup>2</sup>

### The Compact:

- Outlines the types of games that are permitted at gaming facilities;
- Establishes technical standards for gaming machines;
- Authorizes and provides procedures for the State to inspect and audit gaming facilities;
- Requires state certification for tribal gaming facility vendors and employees; and
- Requires the tribes to contribute a percentage of their gaming revenue to state and local governments.

Source: Auditor General staff review of the Compact.

## Department responsibilities and activities

The Department's responsibilities include overseeing tribal gaming and pari-mutuel racing and wagering, providing staff support to the Boxing and MMA Commission for boxing and mixed martial arts events, and providing support for problem gambling prevention, treatment, and education. Specifically:

- **Tribal Gaming**—The Department is responsible for regulating and overseeing tribal gaming in the State, and has established several functions to help ensure compliance with the Compact through the following:
  - **Compact Compliance Reviews (CCRs)**—The Department conducts annual CCRs of all 24 tribal gaming facilities in Arizona to assess these facilities' compliance with the Compact. The Department has developed a standardized audit plan and complementary checklists to guide department staff in their annual review of tribal gaming facility operations. The audit plan covers all auditable areas of the

<sup>1</sup> Class III gaming facilities are authorized to operate games such as slot machines, house-banked poker, and blackjack. The games of roulette, craps, and baccarat are not allowed in Arizona.

<sup>2</sup> Pari-mutuel wagering is a form of wagering on an event outcome in which all wagers are pooled and held by a body for distribution of the total amount, less the deductions authorized by law, to holders of tickets on the winning contestants.

**Figure 1**  
**Class III tribal gaming facility locations in Arizona**  
(Unaudited)



Source: Auditor General staff compilation of tribal gaming facility addresses provided by the Department.

Compact, such as the review of tribal revenue reports that are used to determine tribal contribution rates for gaming monies remitted to the State and local governments and assessing security and surveillance at tribal gaming facilities (see textbox for examples of CCR areas covered and Appendix A, pages a-1 through a-3, for descriptions of all compact sections and appendices). As part of the CCR process, the Department reviews findings with the tribal gaming facility and prepares a preliminary CCR report, which lists the identified compact violations so that the tribal gaming facility can begin addressing the violations.

Auditors observed an on-site review of a tribal gaming facility in November 2017 and found that the Department adhered to its CCR process and audit plan for the areas observed.

### Example requirements reviewed during a CCR:

- Nature, size, and operation of class III gaming;
- Tribal-state licensing and certification procedures and requirements;
- Payment of tribal contributions;
- Public health, safety, and welfare;
- Technical standards for gaming devices; and
- Security and surveillance.

Source: Auditor General staff review of the Compact and the Department's CCR audit plan.

- **CCR followup**—The Department has established a CCR follow-up process to help ensure tribal gaming facilities address issues of noncompliance. This process includes the Department scheduling a follow-up site visit to identify any outstanding violations that the tribal gaming facility has yet to resolve, the tribe developing a compliance plan to address these outstanding violations and identify a time frame to correct them, and the Department performing continuous monitoring to ensure they are resolved.<sup>3</sup>

Auditors reviewed reports from 11 CCRs completed in 2016 and 2017, and found that the Department adhered to its follow-up process for these 11 CCRs and that tribal gaming facilities had resolved, or were in the process of resolving, all violations.

- **Review of revenue and contributions**—According to the Compact, each tribe is required to contribute a percentage of their gaming revenues based on the amount of revenue the tribe collected (see Figure 2, page 4, for information about contribution rates).<sup>4</sup> These gaming revenue contributions are distributed to local governments, the Department for gaming regulation, and various state funds.<sup>5</sup> Specifically, 12 percent of tribal gaming contributions are distributed to cities, towns, and counties, with the remaining 88 percent being deposited in the Arizona Benefits Fund. Of this amount, A.R.S. §5-601.02(H)(3) allocates the greater of 9 percent or \$8 million to the Department for gaming regulation and 2 percent for problem gambling programs.<sup>6</sup> Finally, the Department transfers portions of the remaining monies to the Instructional Improvement Fund (56 percent), the Trauma and Emergency Services Fund (28 percent), the Tourism Fund (8 percent), and the Arizona Wildlife Conservation Fund (8 percent). According to the Department's annual report, the fiscal year 2017 tribal gaming contributions to the State and local governments were more than \$102 million (see Figure 3, page 4, for the distribution of fiscal year 2017 tribal gaming contributions).

The Department has established controls to assess whether the tribes are contributing the appropriate amount of gaming monies to the State and local governments, as stipulated by the Compact. Tribes are required to submit revenue reports to the State, which detail all revenue collected from class III games conducted at tribal gaming facilities. The Department has developed monthly and quarterly report

<sup>3</sup> The requirement for tribes to submit a compliance plan is included in a 2009 amendment to the Compact. Three tribes have not signed that amendment and are therefore not required to submit a compliance plan. As sovereign nations, each tribe can choose to enter into agreements with the State.

<sup>4</sup> The Department has jurisdiction to collect contributions from only class III gaming revenue.

<sup>5</sup> Tribal contributions are distributed according to A.R.S. §5.601.02(H)(3)(4).

<sup>6</sup> A.R.S. §5-601.02(H)(3)(a)(i) states that any monies that are allocated to the Department but not appropriated shall be deposited in the Instructional Improvement Fund.

**Figure 2**  
**Tribal gaming contribution rates and example of an individual tribe’s contribution calculation**  
(Unaudited)

Tribal contribution rates based on the percentage of the tribe’s gaming revenue	Example: if a tribe’s fiscal year gaming revenue totals \$120 million, total contribution would be calculated as follows:
• One percent of the first \$25 million	• \$25 million x 1 percent = \$0.25 million
• Three percent of the next \$50 million	• \$50 million x 3 percent = \$1.50 million
• Six percent of the next \$25 million	• \$25 million x 6 percent = \$1.50 million
• Eight percent of the tribe’s revenue in excess of \$100 million	• \$20 million x 8 percent = \$1.60 million
	<b>Total contribution = \$4.85 million</b>

Source: Auditor General staff summary of the Compact.

**Figure 3**  
**Distribution of total tribal gaming contributions**  
**Fiscal year 2017**  
(Unaudited)

Problem gambling programs	\$ 1,796,785
Gaming regulation	8,083,781
Arizona Wildlife Conservation Fund	6,396,696
Tourism Fund	6,396,696
Cities, towns, and counties	12,171,877
Trauma and Emergency Services Fund	22,388,436
Instructional Improvement Fund	44,776,871
<b>Total contributions for fiscal year 2017</b>	<b>\$102,011,142</b>

Source: Auditor General staff summary of the Department’s fiscal year 2017 tribal contribution report to the Governor.

templates for the tribes to complete, and the Compact requires the financial statements for all tribal gaming facilities to be audited annually by an independent certified public accountant. Specifically:

- **Monthly reports** contain gross gaming revenue and allowable deductions for each gaming activity, such as revenue from slot machines, poker tables, and blackjack tables.<sup>7</sup> Department procedures require staff to review all monthly reports, check and verify deductions, investigate variances in revenues month to month, and verify that the monthly net revenue is calculated accurately.
- **Quarterly reports** contain the same information as the monthly reports, but also include a quarterly summary of net revenue and the calculation for the tribe’s quarterly gaming contributions that are transferred to the State and local governments. Department procedures require staff to review all quarterly reports, check and verify deductions, and ensure accurate calculation of contribution rates.

<sup>7</sup> Gross gaming revenue is the difference between gaming wins and losses, before deducting costs and expenses.

- **Annual external audit reports** include an attestation by an independent certified public accountant for the tribe's gaming revenue for the year. Department procedures require staff to verify that each tribe has submitted their annual external audit report and compare gaming revenue reported in the audited financial statements against the numbers the tribes submitted in their monthly and quarterly reports.

Auditors' review of a 2017 monthly and a 2017 quarterly report determined that department staff followed department procedures for reviewing these two reports. Additionally, auditors reviewed all independent certified public accountant annual audited financial statements the tribes submitted in fiscal year 2016 and found that all tribes received an external audit, and the gaming revenue reported by the tribes and audited by external auditors matched the gaming revenue amounts the tribes reported on a monthly and quarterly basis to the Department.

- **Continuous gaming monitoring**—The Department conducts routine on-site inspections of gaming facilities to assess compliance with specific parts of the Compact that relate to law enforcement, security, and safety, such as security staffing and surveillance. Auditors' review of calendar year 2017 department routine inspection reports found that each tribal gaming facility location was visited at least once per month. Additional on-site visits were made to further inspect compact violations from prior routine inspections and compact violations previously identified in a CCR report compliance plan. The Department tracks compact violations found during routine inspections, and as of February 2018, had identified a total of 49 violations since April 2016, 4 of which were unresolved. Of the 4 unresolved violations, the Department was waiting for the tribe's response on one, two tribal gaming facilities had developed compliance plans, and the Department was re-reviewing one compliance plan.

Additionally, the Compact requires tribes to submit incident reports to the Department for each tribal gaming facility they operate. These incident reports notify the Department of any suspected compact violations identified by tribal gaming facility management, such as a broken lock on an electronic gaming device, as well as any unusual occurrence in gaming facilities, such as patron disputes. The Department reviews, categorizes, and tracks these incident reports in a database system and runs trend reports to monitor potential repeat incidents. According to the Department's fiscal year 2017 annual report, department staff reviewed and classified 9,351 incidents. Finally, during CCRs and routine inspections, department staff review tribal gaming facility incident logs to ensure that all incidents have been reported to the Department.

- **Gaming device compliance**—The Department inspects and certifies hardware and software for electronic gaming devices, such as slot machines, electronic roulette, and redemption/ATM kiosks to ensure they are functioning properly. Every electronic gaming device and kiosk is inspected and certified prior to being put into use at gaming facilities. Additionally, department staff conduct random inspections at the gaming facilities by testing machines and reviewing tribal gaming facility records to ensure continued device compliance with the Compact and that no settings or software have been modified.
- **Vendor certification**—The Department certifies vendors who conduct business with Arizona gaming facilities, such as gaming device manufacturers and distributors. Additionally, the Department must certify vendors providing services in excess of \$10,000 per month, such as food, linens, or janitorial supplies. Applicants for certification must undergo a review of their financial records, such as tax records, prior to the Department's certification. According to the Department's fiscal year 2017 annual report, it approved 80 new vendor certifications and 296 vendor certification renewals (see Finding 1, pages 11 and 12, for more information regarding vendor certification).
- **Employee certification**—The Department certifies tribal gaming facility employees such as dealers, cashiers, and surveillance supervisors to ensure that only suitable individuals are employed at Arizona's gaming facilities. This process includes criminal background checks, fingerprinting, financial background screenings, and reviews of work histories, criminal/civil litigation, education, and tax records, as well as character references. Employee certifications are valid for 1 year. According to the Department's fiscal year 2017 annual report, it approved a total of 1,624 new tribal gaming facility employee applications for state

certification/tribal license and 7,306 renewal tribal gaming facility employee applications (see Finding 1, pages 12 through 14, for more information regarding gaming employee certification).

- **Gaming intelligence**—The Department also enforces the Compact by ensuring that illicit and unregulated gambling is stopped, such as illegal poker rooms. To do so, the Department has sworn officers who perform criminal investigations and undercover operations. The Department reported that this activity is conducted in partnership with law enforcement officers, the Maricopa County Attorney's Office, and/or the Attorney General's Office to close illegal gambling operations.
- **Problem gambling**—The Department supports problem gambling prevention, treatment, and education programs throughout the State. The Department coordinates the training of licensed counselors throughout Arizona who treat those individuals with gambling-related issues. It also advertises on billboards and in the media to increase awareness of these services. According to the Department's fiscal year 2017 annual report, 875 individuals received problem gambling services.
- **Pari-mutuel racing and wagering**—The Department, in conjunction with the Arizona Racing Commission (Racing Commission), is responsible for regulating and overseeing pari-mutuel horse racing and wagering conducted in Arizona.<sup>8</sup> As of April 2018, operating racetracks in Arizona included Turf Paradise in Phoenix and Rillito Park Racetrack in Tucson. The Department licenses various individuals involved in horse racing, such as horse owners, trainers, jockey agents, authorized agents that represent horse owners or trainers, and business vendors. As part of its licensing activities, the Department reviews the criminal background history of licensing applicants, facilitates equine and human drug tests, and collects revenues from pari-mutuel wagering taxes for the State. Further, the Department has a state veterinarian who is responsible for overseeing the testing barn and oversees all private veterinarians at the racetrack. The Department reported that it issued 2,701 licenses related to horse racing and pari-mutuel wagering in fiscal year 2017.

In comparison, statute requires the Racing Commission to determine on which dates horse tracks can conduct races, to prepare and adopt rules to govern races, and to approve racetrack permits. Additionally, the Racing Commission is authorized by statute to conduct rehearings, which are reviews of licensing decisions and licensee disciplinary decisions the Department makes. For example, if an applicant is denied a license by the Department and disagrees with the denial, the applicant may file an appeal to the Racing Commission. Pursuant to statute, the Racing Commission also conducts reviews of applications to construct capital improvements at racetracks.<sup>9</sup> Finally, the Department completes administrative reviews of race permit applications and presents this information to the Racing Commission, which has the authority to approve or deny the permits. Specifically, the Department ensures that the permit applications include all required information specified in statute and then provides a recommendation to the Racing Commission for approval or denial of the racing meet permit.

- **Boxing and mixed martial arts**—Although the Department does not regulate boxing and mixed martial arts, it provides staff support to the Boxing and MMA Commission, which is responsible for regulating all professional boxing and mixed martial arts events conducted in Arizona. This includes activities such as licensing those involved in matches and developing rules for boxing and mixed martial arts. For example, under the authority of the Boxing and MMA Commission, the department staff review and approve applications for licensure and help oversee boxing and mixed martial arts events and work full-time on Boxing and MMA Commission responsibilities.

## Organization and staffing

According to department staff, when the Department and the Arizona Department of Racing were combined, several vacant positions from the Arizona Department of Racing became department positions. Although the Department has the authority to eliminate vacant positions, it has not done so. Department staff are organized

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<sup>8</sup> As of January 1, 2017, greyhound racing in Arizona is prohibited. The last greyhound race in Arizona was held in June 2016.

<sup>9</sup> A.R.S. §5-104(A)(1-4).

into various divisions, and according to department records as of June 2018, the Department had 100 filled full time equivalent (FTE) positions and 104 vacant FTEs, which have the following responsibilities and staffing:<sup>10</sup>

- **Administration (15 filled FTEs, 12 vacancies)**—Includes various management and support staff, such as information technology, procurement, human resources, finance, the Office of Continuous Improvement, and clerical staff.
- **Gaming (71 filled FTEs, 37 vacancies)**—Ensures compact compliance through areas such as investigation and inspections, gaming intelligence, vendor and employee certification, machine compliance, and audit.
- **Racing (8 filled FTEs, 52 vacancies)**—Regulates and supervises pari-mutuel horse racing and wagering conducted in Arizona.
- **Boxing/Mixed Martial Arts (2 filled FTEs, 2 vacancies)**—Provides staff support to the Boxing and MMA Commission in areas such as licensing, regulation, health, and safety.
- **Problem Gambling (4 filled FTEs, 1 vacancy)**—Provides problem gambling prevention, treatment, and education programs throughout the State.

## Budget

The Department receives revenues from various sources. As shown in Table 1 (see page 8), for fiscal year 2017, the Department's revenues totaled approximately \$19.1 million, and the Department estimated that it will receive approximately \$16.1 million in revenues in fiscal year 2018. In fiscal year 2017, the Department received a majority of its revenue, nearly \$11.6 million, from tribal contributions for regulating the Compact and tribal gaming facility employee and vendor certification fees. The Department also received revenues from racing licenses and fees; the State Lottery Fund, which are used for problem gambling programs; pari-mutuel taxes; charges for services; and fines, forfeits, and penalties. Additionally, the Department receives some revenue from the State General Fund, which the Department passes through to the County Fairs Livestock and Agricultural Promotion Fund, and in fiscal year 2017, it received \$200,000 to award the breeder of every winning horse foaled in the State.<sup>11</sup> For fiscal year 2017, the Department's expenditures totaled approximately \$15 million, and the Department estimated that its expenditures for fiscal year 2018 will total approximately \$14.9 million. Payroll and related benefits and professional and outside services accounted for most of these expenditures.

At the end of fiscal year 2017, the Department had an ending fund balance of approximately \$6.6 million. Of that amount, approximately \$1.86 million was from the Racing Regulation Fund, which provides monies to regulate horse racing in Arizona. The Department estimates it will have an ending fund balance of nearly \$6 million for fiscal year 2018, which will include an estimated \$1.85 million from the Racing Regulation Fund. The Department estimates the Racing Regulation Fund's fund balance will continue to decrease because the Regulatory Wagering Assessment (RWA) was reduced during the 2017 legislative session.<sup>12</sup> The RWA provides most of the monies in the Racing Regulation Fund and is an amount assessed on the pari-mutuel (betting) pool revenues from both live and simulcast races and deposited into the Racing Regulation Fund by the permittees. The Racing Regulation Fund also includes license fee revenues collected from individuals or corporations involved in boxing and mixed martial arts contests, such as managers, promoters, ringside physicians, and trainers; which is used to pay for department staff who support the Boxing and MMA Commission.

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<sup>10</sup> According to the Department, it is considering reducing its number of FTE positions but plans to retain some of these vacant FTE positions to provide it with some flexibility in hiring additional staff if its gaming and/or racing regulatory responsibilities increase.

<sup>11</sup> According to statute, the County Fairs Livestock and Agricultural Promotion Fund is established under the control of the Governor and shall be used for the purpose of promoting the livestock and agricultural resources of the State and for the purpose of conducting an annual Arizona national livestock fair by the Arizona Exposition and State Fair Board to further promote livestock resources.

<sup>12</sup> The Legislature lowered the RWA rate to 0.5 percent from the previous rates of 0.75 during the nonlive racing season and 0.85 during the racing season.

**Table 1**  
**Schedule of revenues, expenditures, and changes in fund balance**  
**Fiscal years 2015 through 2018**  
(Unaudited)

	2015 (Actual)	2016 (Actual)	2017 (Actual)	2018 (Estimate)
Revenues				
Compact regulation and certification fees <sup>1</sup>	\$11,522,119	\$11,965,097	\$11,583,521	\$11,000,000
Licenses and fees, primarily racing		2,528,503	2,695,157	2,454,939
Legal expenditure reimbursements <sup>2</sup>		1,761,855	2,175,000	400,000
State General Fund appropriations <sup>3</sup>		1,779,500	1,979,500	1,779,500
State Lottery Fund <sup>4</sup>	300,000	300,000	300,000	300,000
Taxes, primarily pari-mutuel		190,660	174,987	175,029
Charges for services		69,163	88,377	56,541
Fines, forfeits, and penalties		30,109	238,439	27,417
Other	2,792	54	11,623	968
<b>Total gross revenues</b>	<b>11,824,911</b>	<b>18,624,941</b>	<b>19,246,604</b>	<b>16,194,394</b>
Credit card transaction fees		(1,114)	(411)	(2,000)
Remittances to the State General Fund		(45,737)	(151,770)	(80,000)
<b>Total net revenues</b>	<b>11,824,911</b>	<b>18,578,090</b>	<b>19,094,423</b>	<b>16,112,394</b>
Expenditures and transfers				
Payroll and related benefits	7,988,991	8,823,811	8,502,719	8,856,846
Professional and outside services	1,700,567	4,078,140	3,409,139	2,938,604
Travel	354,890	351,928	368,513	427,597
Other operating <sup>5</sup>	1,127,676	2,274,182	2,571,357	2,415,810
Furniture, equipment, and software	300,920	122,928	191,028	230,000
<b>Total expenditures</b>	<b>11,473,044</b>	<b>15,650,989</b>	<b>15,042,756</b>	<b>14,868,857</b>
Transfers to the County Fairs Livestock and Agricultural Promotion Fund <sup>3</sup>		1,779,500	1,779,500	1,779,500
Transfers to the other agencies <sup>6</sup>	1,000	3,845	1,203,717	57,925
<b>Total expenditures and transfers</b>	<b>11,474,044</b>	<b>17,434,334</b>	<b>18,025,973</b>	<b>16,706,282</b>
Net change in fund balance	350,867	1,143,756	1,068,450	(593,888)
Department fund balance, beginning of year	2,774,095	3,124,962	5,483,812	6,552,262
Division of Racing fund balance, beginning of year <sup>7</sup>		1,215,094		
<b>Fund balance, end of year</b>	<b>\$ 3,124,962</b>	<b>\$ 5,483,812</b>	<b>\$ 6,552,262</b>	<b>\$ 5,958,374</b>

<sup>1</sup> Compact regulation fees are a portion of gaming revenues paid to the State as established by the Compact. These fees support the Department's tribal gaming regulation functions and provide funding for the problem gambling program. Certification fees are assessed to persons seeking employment at a tribal gaming facility and vendors that provide services at a tribal gaming facility. These fees support the Department's certification functions. Amount does not include the portion of the received compact fees that are distributed to other agencies in accordance with A.R.S. §5.601.02(H)(3), such as the Arizona Department of Education for its Instructional Improvement Fund.

<sup>2</sup> Legal expenditure reimbursements are monies received from the Arizona Department of Administration, Division of Risk Management, to reimburse the Department for expenditures it incurred for legal representation for three lawsuits.

<sup>3</sup> The Department received approximately \$1.8 million from the State General Fund that was transferred to the County Fairs Livestock and Agricultural Promotion Fund as required by Laws 2015, Ch. 8, §87. The Fund is administered by the Office of the Governor and used to promote Arizona's livestock and agricultural resources and conduct an annual Livestock Fair at the Coliseum and Exposition Center. Prior to fiscal year 2016, transfers to the County Fairs Livestock and Agricultural Promotion Fund were made by the Arizona Department of Racing. In addition, in fiscal year 2017, the Department received \$200,000 from the State General Fund for the Arizona Breeders' Award, which awards monies to the breeder of every winning horse foaled in the State.

## Table 1 footnotes (continued)

- <sup>4</sup> State Lottery Fund revenues are the portion of the State Lottery Fund appropriated to the Department for the problem gambling prevention program. The State Lottery Fund revenues are composed of lottery ticket sales, retailer license fees, and interest earnings.
- <sup>5</sup> Other operating expenditures are composed of various expenditures, including rent, advertising, and fingerprinting and background checks.
- <sup>6</sup> For fiscal year 2017, includes transfers to the Arizona Office of Administrative Hearings for hearings; Arizona Department of Administration for training and a portion of the costs for a new procurement system; and the Arizona Department of Education's Instructional Improvement Fund.
- <sup>7</sup> Beginning in fiscal year 2016, Laws 2015, Ch. 19, §2, eliminated the Arizona Department of Racing and stipulated that its fund balance be transferred to the Department, where the Division of Racing was created within the Department.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2015 through 2017; the State of Arizona *Annual Financial Report* for fiscal years 2015 through 2017; and department-provided financial information for fiscal year 2018.





## Department appropriately certified gaming vendors and employees reviewed, but should continue to enhance employee recertification process

In fiscal year 2017, the Arizona Department of Gaming (Department) appropriately certified tribal gaming facility vendors and tribal gaming facility employees auditors reviewed, but should continue its efforts to ensure that employees receive all required financial background investigations when applying for certification renewal. According to the Tribal-State Compact (Compact), the Department is required to certify vendors who conduct business with gaming facilities, such as gaming device manufacturers and security services providers. Additionally, the Department certifies gaming facility employees such as dealers, floor managers, and cashiers.<sup>13</sup> For the fiscal year 2017 certification and renewal files reviewed, auditors found that the Department reviewed and approved initial vendor and employee certification applications properly but should continue to improve its certification renewal process for some employees.

## Compact requires vendors to be certified, and Department appropriately certified vendors auditors reviewed

Auditors' review of a sample of fiscal year 2017 vendor certification files found that the Department appropriately certified the vendors who met certification requirements. The Compact requires that vendors who do business with tribal gaming facilities be certified by the Department and the Compact outlines the certification requirements for the three types of vendor certifications issued by the Department (see textbox for certification descriptions).

### Gaming vendor certification types<sup>1</sup>

- **Class A**—Includes certification for gaming facility financiers, gaming device manufacturers, and distributors.
- **Class B**—Includes certification for vendors who provide security devices, currency handling equipment or check cashing services, or gaming data analysis software/systems.
- **Class D**—Includes certification for vendors who bill gaming facilities \$10,000 or more per month for services or products they provide, such as food, linens, janitorial supplies, maintenance, or security services.

<sup>1</sup> The Department reported that there is no Class C vendor certification type.

Source: Auditor General staff review of the Compact, the Department's website, and vendor application forms.

Specifically, all vendor applicants must submit several items to the Department to qualify for certification, such as application forms, the required certification fee, fingerprint cards for company executives, financial statements that demonstrate evidence of no tax liability, and organizational charts. Pursuant to the Compact, the Department is required to issue a temporary certification within 20 days after all required forms and documentation are submitted. During the 20-day period, Department staff are required to review the submitted documentation and conduct a background check of the vendor's executives. If the Department does not identify any concerns as part of this review, it must issue a temporary certification. After the temporary certification is issued, department

<sup>13</sup> The Compact does not require the State to certify tribal gaming facility employees who are members of the tribe operating the gaming facility. These employees are licensed only by the tribal gaming office.

staff are required to conduct additional investigation of the vendor and its principal employees' financial and tax records prior to issuing or denying a permanent certification. Although the Compact establishes a time frame for the Department to issue temporary certifications, it does not establish a time frame to issue permanent or renewal vendor certifications. Vendors must renew their certifications every 2 years and must submit updated materials to the Department as requested, such as updated fingerprint cards and tax records. However, vendors are not required to resubmit historical data already on file with the Department.

For the fiscal year 2017 vendor certification files auditors reviewed, the Department appropriately and timely certified vendors that conduct business with gaming facilities. Auditors reviewed all three class A and all three class B new vendor certifications issued in fiscal year 2017. In addition, auditors reviewed a random sample of 4 of the 74 class D new vendor certifications issued in fiscal year 2017. Of the 10 total certifications reviewed, auditors found that all 10 were issued to vendors who met the certification requirements, and 9 were issued a temporary certification within the 20-day time frame. In the one case where the Department did not issue a temporary certification within 20 days, the Department had initially denied the certification because one of the vendor's executives had a criminal record.<sup>14,15</sup> According to the Compact, if an applicant's prior criminal record poses a threat to the public interest of the tribe or the State, the Department may deny the application for certification. Additionally, this vendor, a repair and parts supplier for electronic gaming devices, had conducted business with a tribal gaming facility prior to applying for certification, another compact violation. The vendor appealed the denial and requested an informal settlement conference, which is allowed pursuant to the Compact. As part of the settlement conference, the vendor provided documentation that showed the executive had taken corrective measures to address the criminal charges by attending intervention classes, which resulted in these charges being dismissed. Therefore, the Department determined that the individual no longer represented a threat to the public interest. Further, the vendor agreed to enter into a settlement agreement with the Department that included a \$5,000 fine because the vendor had conducted business with a tribal gaming facility prior to applying for certification. After the Department reached an agreement with the vendor, the Department rescinded its intent to deny certification and ultimately issued the vendor a permanent certification to legally conduct business with the gaming facilities.

Auditors also reviewed a random sample of 5 of the total 231 vendor renewal certifications the Department issued between October 1, 2016 and June 30, 2017, and found that the Department appropriately issued the 5 certification renewals to vendors who met the requirements for renewal by reviewing completed renewal packets, receiving renewal fees, completing background checks, and reviewing tax records.

## **Compact requires gaming facility employees to be certified, and Department appropriately issued initial employee certifications reviewed, but needs to perform required expanded financial background checks when renewing some employee certifications**

Auditors' review of random samples of fiscal year 2017 employee certifications and renewals found that the Department appropriately issued initial employee certifications but did not always perform the required financial background check when renewing the certification for individuals in gaming-management positions. The Compact requires the Department to certify gaming employees in Arizona. There are three types of employee certifications for tribal gaming: (1) nonmanagement gaming employees, (2) key gaming employees, and (3) sensitive management position employees (SMP) (see textbox on page 13).<sup>16</sup> All gaming employee certifications are valid for 1 year.

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<sup>14</sup> The Department sent the intent to deny notification to the vendor within 20 days of receiving the vendor's completed application packet.

<sup>15</sup> The executive was arrested in April 2015 in Texas for indecent exposure.

<sup>16</sup> Tribal members who are applying for a position at a tribal gaming facility of the tribe they are a member of are not required to receive state certification to be employed. Additionally, employees without access to secure areas, such as food and beverage personnel, landscapers, and valets, are not required to be certified.

To be certified, all applicants must comply with various requirements, such as submitting a fingerprint card and current photograph, as well as passing a background investigation conducted by the Department. Once an application is received, department staff are required to review applicants' employment history, criminal history, and personal references, and may also review education and tax information. Department staff then record the application information in the Department's certification database. Additionally, because key and SMP applicants are in critical positions of authority, the Department's policy is to conduct an expanded review of those applicants' financial records, such as a review of bank and tax records.<sup>17,18</sup> To renew their certification, applicants are required to submit a renewal application and provide updated information for only those areas that have changed since the initial background check was performed, such as criminal history or gaming license status. Department staff also enter renewal application information in the certification database during the renewal process. Further, although the Compact requires certifications to be renewed annually, department policy indicates that department staff should perform the expanded financial background check for renewal SMP applicants at least once every 2 years.

## Gaming employee certifications

- **Nonmanagement gaming employees**—Include blackjack dealers, machine technicians, cashiers, and game attendants.
- **Key gaming employees**—Include floor managers, cashier managers, poker managers, surveillance supervisors, and finance and administration managers.
- **SMP gaming employees**—Include casino managers, directors of internal audit, finance directors, security directors, and general managers. The Compact indicates that these persons have authority to hire and fire employees or set up working policy for the gaming operation or are persons who have financial management responsibility for the gaming operation.

Source: Auditor General staff review of the Compact and interviews with department staff.

The Department issued the fiscal year 2017 gaming employee initial certifications that auditors reviewed to qualified employees but should continue its efforts to ensure that tribal gaming facility employees in sensitive management positions receive the required expanded financial background checks before certification renewal. To determine whether the Department appropriately certified initial and renewal applicants, auditors reviewed a random sample of 15 of the 1,104 initial certifications and 15 of the 4,155 renewal applications submitted during fiscal year 2017. Specifically, auditors examined 10 nonmanagement gaming employee initial applications, 10 nonmanagement gaming employee renewal applications, 5 initial key and SMP gaming employee initial applications, and 5 key and SMP gaming employee renewal applications. Auditors found that the Department appropriately reviewed all 15 initial certification applications and issued certifications to qualified applicants. However, department staff did not review 3 of the 15 renewal applications according to department policy. Specifically, the Department did not conduct an expanded financial background check of bank and tax records before renewing three SMP certifications, contrary to department policy.<sup>19</sup>

Department staff identified multiple reasons why these SMP renewal applications may not have received the expanded financial background check, and during the audit began taking steps to address these issues. Specifically, the Department took the following steps:

- **Reference guide developed to note which individual is in each SMP position**—The Department began drafting a reference guide in October 2017, which shows all SMPs at each tribal gaming facility using organizational charts provided by tribal gaming offices. The Department reported that this reference guide will allow the tribal gaming offices to clearly identify SMP employees at their gaming facilities to help

<sup>17</sup> According to the Compact, applicants may be denied certification for multiple reasons, including having been convicted of forgery, larceny, extortion, and conspiracy to defraud or for being a person whose prior activities or criminal record pose a threat to the public's or tribes' interest or the State's ability to effectively regulate gaming.

<sup>18</sup> The Compact does not establish an overall time frame requirement for certifying gaming employees.

<sup>19</sup> During the audit, the Department performed the expanded financial background check for the three SMP employees who did not originally receive it. For two employees, the background check did not reveal any disqualifying information. The third applicant left his/her position before the check was completed, so the Department halted the review.

ensure that the Department performs the required expanded financial background check for all appropriate individuals. The Department began developing this reference guide because department staff are not notified when gaming employees change positions at the gaming facilities, and therefore the Department may not perform the required expanded financial background check when renewing certifications for employees who move into SMP positions. In fact, in all three cases where auditors identified that a renewal applicant did not receive the required expanded financial background check, the applicant transferred from another gaming facility position to an SMP position. Additionally, department staff reported that inconsistent job titles between gaming facilities make it difficult to determine which employees are in SMP positions. For example, the Department indicated that the “surveillance manager” position at one facility is called a “site manager” at a different facility. As of June 2018, the Department had not finalized the reference guide.

- **Department modified database to indicate SMP status**—In January 2018, the Department created a permanent notation within its certification database that would allow department staff to clearly identify SMP employees during the renewal process. However, prior to this change, the Department’s certification database did not indicate the type of certification a particular employee held, thus limiting the Department’s ability to specifically identify SMP employees. By not specifically identifying SMP employees, the Department was at risk for not performing the required expanded financial background check.

Therefore, the Department should continue its efforts to ensure that all SMP employees are properly identified and classified to ensure they receive the required expanded financial background check at the time of renewal. In addition, the Department should incorporate the changes it has made to identify SMP employees into its policies, procedures, and/or training manual for employee certification, and then train staff accordingly.

## Recommendations

- 1.1. The Department should continue its efforts to ensure that all SMP employees are properly identified and classified to ensure they receive the required expanded financial background check at the time of renewal.
- 1.2. The Department should incorporate the changes it has made to identify SMP employees in its policies, procedures, and/or training manual for employee certification, and then train staff accordingly.



# Department should enhance horse racing licensure process to better ensure it appropriately issues all licenses in a timely manner

The Arizona Department of Gaming (Department) should improve its horse racing licensing practices to ensure that it conducts criminal background investigations and licensing interviews effectively and consistently. The Department licenses a variety of horse racing participants, such as jockeys and horse trainers, and applicants must submit required information and fees and undergo a background investigation to become licensed. Although the Department appropriately processed and issued licenses auditors reviewed, it can improve some aspects of its background investigation process. Specifically, the Department should perform name-based criminal history records checks when fingerprint-based checks cannot be performed, cross-train staff to ensure background investigations are completed in a timely manner, and expand its supervisory review process for licensing decisions. Finally, the Department should implement policies and procedures for conducting licensing interviews.

## Department's horse racing licensing process allows it to issue temporary licenses

The Department's licensing process is generally different from Arizona state regulatory boards in that statute allows the Department to issue temporary licenses to applicants who meet a portion of the initial licensing requirements. According to department staff, individuals employed in the racing industry often travel from state to state, and some applicants arrive at Arizona racetracks to apply for licensure the day of a race. The issuance of a temporary license allows those applicants to work at a racetrack the same day that they apply. The practice of issuing temporary licenses within the horse racing industry is not unique to Arizona—auditors identified four states that have a similar practice (see Sunset Factors, page 27, for more information). Further, department staff reported that temporary licensing for horse racing is commonplace across the nation. Most licensing applicants apply in person at the Turf Paradise and Rillito racetracks in Phoenix and Tucson, respectively, when they arrive at the racetracks to perform work related to race meets, but the Department reported it also receives some license applications through the mail. The Department issues 24 different types of licenses and reported that it issued a total of 2,701 licenses during fiscal year 2017 (see textbox for examples of licensing categories).

To be licensed, an applicant must complete a licensing application form, pay the required licensing fees, and submit two sets of fingerprint cards. The Department must conduct a background investigation, which includes submitting the fingerprint cards to the Arizona Department of Public Safety (DPS) and the Federal Bureau of Investigation (FBI) for a criminal history records check, and reviewing court and law enforcement agency records, as required by rule (see pages 16 through 18 for more information on DPS and FBI background checks). Department staff should also conduct a preliminary background investigation of the applicant at the time of application, including a check

### Example horse racing licensing categories

- **Jockey**—A person who rides horses in horse racing, primarily as a profession.
- **Owner**—Any person possessing all or part of the legal title to a horse.
- **Trainer**—A person an owner employs to condition a horse for racing.

Source: Auditor General staff review of Arizona Administrative Code (AAC) Title 19, Ch. 2.

through a national database containing license information and rulings related to horse racing and a check of the Department's internal licensing database, which includes an applicant's historical licensing information in Arizona. Applicants applying for specific categories of licenses are required to fulfill additional licensing requirements. For example, rule requires that an applicant for a horse trainer's license who has not been licensed as a trainer in the last 10 years demonstrate "knowledge and skill in protecting and promoting the safety and welfare of animals participating in race meets" by passing an examination and completing an interview prescribed by the Department.<sup>20</sup>

If an applicant has met the initial licensing requirements except for passing the criminal history records checks from the DPS and the FBI, they should be issued a temporary license upon application, which becomes a permanent license after 90 days. During this 90-day period, the Department should complete its background investigation by reviewing all criminal history records information received from the DPS and the FBI. If the results of the background investigation indicate that the individual is suitable for licensure, the Department does not take any further action, and the temporary license automatically becomes permanent at the end of the 90-day period. If the results of the background investigation indicate that the individual has not met the requirements for licensure, pursuant to statute, the Department should revoke the temporary license. The Department issues licenses that are valid for either 1 or 2 years depending on the license category, and all applicants must complete the entire application process again to obtain a new license.

## Department appropriately processed and issued licenses reviewed but should improve some licensing practices

The Department appropriately processed and issued the racing licenses auditors reviewed but should improve its licensing practices regarding background investigations and licensing interviews. Specifically, the Department appropriately reviewed, processed, and issued all 30 licenses that auditors reviewed, but it should enhance its background investigation processes by pursuing name-based federal criminal history records checks through the FBI when fingerprint-based background checks are not feasible.<sup>21</sup> Additionally, the Department should better ensure that background investigations are completed in a timely manner by cross-training department licensing staff. Finally, the Department should expand its supervisory review process for licensing decisions and implement policies and procedures for licensing interviews.

**Department appropriately reviewed, processed, and issued licenses**—Auditors reviewed a random sample of 30 licenses that the Department issued between July 2015 and June 2017, and found that it appropriately reviewed, processed, and issued all 30 licenses.<sup>22</sup> Specifically, all 30 applicants submitted the required application, licensing fees, and two sets of fingerprint cards. Further, prior to issuing the temporary licenses, the Department reviewed records of a national database containing license information and rulings, and checked its internal licensing database. Lastly, for the 30 licenses, the Department submitted the fingerprint cards to the DPS for the state and federal criminal history records check.

**Department should improve its background investigation processes**—As noted previously, the Department is required by rule to perform a multi-step background investigation of licensing applicants that includes fingerprint processing to obtain criminal history records information through the DPS and the FBI.<sup>23</sup> When applicants apply for a license, the Department takes two sets of fingerprints that are submitted to the DPS for a state criminal history search.<sup>24</sup> The DPS then digitally scans an applicant's fingerprints to the FBI for a federal

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<sup>20</sup> AAC R19-2-106(B)(5).

<sup>21</sup> For 1 of the 30 licenses auditors reviewed, the Department was unable to provide the completed application for this license. According to department staff, this application was unable to be located due to the Department's migration to a paperless system in late 2017. However, auditors found evidence that the appropriate fees were paid and that the fingerprint cards for the applicant were submitted to the DPS.

<sup>22</sup> Auditors sampled from jockey, groom, exercise rider, trainer, owner, and occupational licenses. The Department issued a total of 3,101 licenses in these six categories from July 2015 through June 2017.

<sup>23</sup> AAC R19-2-105(D)(5).

<sup>24</sup> If the first set of fingerprints is unreadable, the Department will submit the second set of fingerprints.

criminal history search. The DPS search reviews an applicant's criminal history in Arizona, while the FBI search reviews an applicant's criminal history nation-wide. Once these searches are completed, the DPS provides a full criminal history report to the Department containing the results from both searches. The Department reviews these results to determine whether the applicant has a criminal history that would, according to statute, be reason to revoke the temporary license. For example, if the Department finds that an applicant has intentionally provided false information regarding his/her criminal history on the license application, pursuant to statute, the Department should revoke the temporary license. Although auditors found that the Department followed the process outlined in statute and rule for conducting background investigations of licensing applicants, the Department can improve its background investigation processes in the following ways:

- **Pursue name-based federal criminal history records checks when necessary**—Auditors reviewed a random sample of 30 licenses issued between July 2015 and June 2017 and found that the Department obtained and submitted fingerprint cards to the DPS for all 30 licenses. However, two licenses did not receive criminal history records information from the DPS or the FBI. Specifically, the DPS was unable to perform a criminal history records check because one applicant's fingerprints were unreadable, and the FBI was unable to perform a criminal history records check for a separate applicant because of unreadable fingerprints.<sup>25</sup> DPS staff reported that due to the manual nature of work in the horse racing industry, applicants' fingerprints may wear at an increased rate, thereby making the fingerprints unusable for performing fingerprint-based criminal history records checks. Further, both DPS and department staff indicated that fingerprints become unreadable as they naturally wear down over time as individuals age.<sup>26</sup>

The Department should pursue an alternative option for performing criminal history records checks when fingerprint-based checks cannot be performed. If the FBI is unable to perform a fingerprint-based check because of poor fingerprint readability, a DPS official reported that state agencies have the option to conduct a name-based federal criminal history records check through the FBI using an applicant's name, date of birth, and social security number.<sup>27,28</sup> The DPS facilitates this process by providing a form to the requesting agency, which is completed and returned to the DPS, which then provides the form to the FBI for the check. Although the DPS reported that name-based checks are generally not as reliable in verifying a person's identity and associated criminal history as fingerprint-based checks, this option would still provide the benefit of additional criminal history records information when a fingerprint-based check is not feasible due to unreadable prints. Further, when fingerprints are unable to be read by the FBI or the DPS, it is the Department's responsibility to demonstrate due diligence in performing a criminal history records check by using all options available. Therefore, the Department should perform name-based criminal history records checks through the FBI when fingerprint-based checks are unable to be performed.

- **Complete background investigations in a timely manner**—The Department's rules require that the Department complete its review of the criminal history records information obtained from the DPS and the FBI within 90 days of license application. As noted previously, the Department issues temporary licenses that, if no further action is taken, automatically become permanent after 90 days. Therefore, it is important for the Department to review all application information, including completing its background investigation by reviewing the results of the criminal history records check within the established time frame, to ensure that applicants who are not fit for licensure are not practicing for an unnecessary period of time.

The Department developed and implemented a system in August 2017 for tracking key steps in the licensing process using an electronic spreadsheet, and based on auditors' review of this spreadsheet, most licenses were processed in a timely manner; however, some were untimely. Specifically, auditors found that 44 of the 1,154 licenses processed from August 2017 through March 2018 took longer than 90 days to process

<sup>25</sup> When DPS rejects fingerprints, it is for the state criminal history records search only. When the FBI rejects fingerprints, it is for the federal criminal history records check.

<sup>26</sup> At the time of application, one applicant was age 54 and the other was age 64.

<sup>27</sup> For an agency to submit a request to the FBI for a name-based search, there must be two FBI-rejected fingerprint cards. The first reject must be within the last year, and the second reject must be within the last 90 days of the name search request.

<sup>28</sup> The DPS is not statutorily authorized to perform a name-based background investigation for the Department.

and render a decision regarding licensure. In fact, 43 of the 44 untimely licenses were processed in January 2018. For these untimely licenses, the average number of days between when the Department received the application and when the criminal history results were obtained from DPS was 11.3 days. However, it took an average of 77.8 days for the Department's special investigator to review the DPS and FBI criminal history records and complete the background investigation. The Department reported it was not able to complete the background investigations in a timely manner during this time frame because the special investigator was out of the office, which resulted in a backlog of licenses that needed to be reviewed for criminal history. In addition, the Department had assigned only one special investigator to review the criminal history results from the DPS and the FBI and render a decision on whether the applicant was suitable for licensure. As a result, when the sole investigator is unavailable, the Department is at risk of developing a backlog in completing background investigations and not meeting its 90-day requirement. Therefore, the Department should cross-train its licensing staff to ensure that there are additional staff trained to complete background investigations and make licensing recommendations and decisions. Further, the Department should continue to track and evaluate its licensing timeliness to ensure it completes background investigations in a timely manner.

- **Expand supervisory review of licensing decisions**—Statute outlines the Department's authority to deny or revoke a temporary license if the applicant has a criminal history record. For example, statute indicates that the Department may revoke a temporary license if the applicant has been convicted of a felony or any crime involving moral turpitude.<sup>29</sup> In addition, the Department has developed some written guidance to help staff assess what constitutes crimes involving moral turpitude, such as embezzlement, forgery, and larceny. However, statute and the Department's policy do not prescribe whether the Department must deny or revoke a temporary license for all circumstances that staff may encounter when reviewing an applicant's criminal history. As such, department staff must use their discretion and judgment in determining whether an individual is suitable for licensure in many cases.

To help ensure that staff are making appropriate licensing recommendations and decisions as part of reviewing applicants' criminal history, the Department has developed a supervisory review process. Specifically, if the results of the background investigation indicate that an applicant has a criminal history that differs from the information disclosed on the application, the Department's special investigator is required to prepare a report that outlines the criminal offenses and include a recommendation as to whether the applicant is suitable for licensure. If the special investigator determines that the temporary license should be revoked based on the applicant's criminal history, the special investigator must submit the report to her supervisor, who reviews the report and decides whether revocation is appropriate. However, if the special investigator determines that the identified criminal history does not make the applicant unsuitable for licensure, there is no formal supervisory review conducted, and the temporary license becomes permanent at the end of the 90-day period. For example, for one of the licensing files that auditors reviewed, the applicant had been convicted of driving under the influence and assault; however, the charges occurred in 2005 and 1999, respectively, and the special investigator determined that the applicant was suitable for licensure because the identified criminal acts had occurred several years ago. However, without supervisory review of these licensing decisions, the Department cannot ensure that the special investigator is making appropriate and consistent licensing recommendations and decisions regarding individuals with criminal history. Therefore, the Department should develop and implement policies and procedures that require the supervisory review of all licensing recommendations and decisions the special investigator makes when applicants have criminal history.

**Department should formalize its process for conducting licensing interviews**—Although the Department has developed a policy that requires department staff to interview applicants for certain license types to ensure they are qualified for licensure, as allowed by rule, it has not developed policies and procedures to guide staff on the information that should be obtained through the interview.<sup>30</sup> The Department's policy outlines under what circumstances license applicants are subject to an interview. For example, the policy indicates that a horse trainer who the Department has not licensed in the past 10 years must be interviewed. The policy also

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<sup>29</sup> Arizona Revised Statutes §5-108(A)(1)(e) and (F).

<sup>30</sup> AAC R19-2-106(D)(2).

indicates that a jockey who has not ridden a horse in the past 12 months must be interviewed. However, the policy does not provide any guidance to staff regarding what information should be obtained through the interview to demonstrate that the applicant is qualified for licensure. Additionally, it is important that the Department determine qualification consistently to ensure all applicants are given the same opportunity to obtain a license and that only qualified applicants are licensed. Therefore, the Department should develop and implement policies and procedures for conducting interviews, such as what information should be obtained through an interview, to ensure that licensing applicants are evaluated consistently and effectively.

## **Recommendations**

- 2.1. The Department should perform name-based background checks through the FBI when fingerprint-based background checks are unable to be performed.
- 2.2. The Department should cross-train its licensing staff to complete criminal background investigations and make licensing recommendations and decisions.
- 2.3. The Department should continue to track and evaluate its licensing timeliness to ensure it completes criminal background investigations in a timely manner.
- 2.4. The Department should develop and implement policies and procedures that require the supervisory review of all licensing recommendations and decisions made by the special investigator when applicants have criminal history.
- 2.5. The Department should develop and implement policies and procedures for conducting interviews, such as what information should be obtained through an interview, to ensure that licensing applicants are evaluated consistently and effectively.





# SUNSET FACTORS

In accordance with Arizona Revised Statutes (A.R.S.) §41-2954, the Legislature should consider the following factors in determining whether to continue or terminate the Arizona Department of Gaming (Department).

The analysis of the Sunset Factors includes seven recommendations not discussed earlier in this report. Specifically, to protect the Department's information technology (IT) systems and the data contained therein, the Department should conduct an IT risk assessment to evaluate, document, and prioritize the areas in the Department's IT systems with the highest security risks. The Department should then use the risk assessment results to develop and implement all necessary policies and procedures in line with IT standards, best practices, and the Arizona Department of Administration's Arizona Strategic Enterprise Technology Office (ASET) standards, focusing on high-risk areas first. The Department should also add supplementary detail to its policies and procedures for conducting tote audits, such as information on verifying the results of the tote audits. Additionally, based on an Office of the Auditor General June 2018 procedural review, the Department should improve internal controls regarding capital assets, compliance with Arizona conflict-of-interest laws, and its financial management of the Arizona Benefits Fund (see Sunset Factor 2, pages 22 through 24). Further, the Legislature should consider aligning the sunset dates of the Arizona Boxing and Mixed Martial Arts Commission (Boxing and MMA Commission), the Arizona Racing Commission (Racing Commission), and the Department to more effectively and in a more timely manner evaluate and address the collective regulation of gaming, racing, and boxing and mixed martial arts in the State (see Sunset Factor 9, page 25).

## **1. The key statutory objectives and purposes in establishing the Department.**

Established in 1995, the Department is responsible for regulating tribal gaming in accordance with the Arizona Tribal-State Gaming Compact (Compact). Specifically, the Department monitors and regulates the nature, extent, and conduct of gaming activities, certifies tribal gaming facility employees and vendors, and investigates violations of the Compact and instances of illegal gambling, such as illegal poker rooms. Additionally, the Department provides problem gambling prevention, treatment, and education throughout the State.

Further, in 2015, the Legislature consolidated the Arizona Department of Racing within the Department. The Department's Racing Division, in conjunction with the Racing Commission, is responsible for regulating commercial and county fair horse racing by licensing various participants involved in horse racing and staffing racetracks with stewards who are responsible for enforcing and interpreting horse racing rules. The Racing Division also regulates pari-mutuel wagering at racetracks and monitors off-track betting locations in the State. Finally, the Department provides staff support to the Boxing and MMA Commission, including performing background checks on applicants for licensure and providing oversight at boxing and mixed martial arts matches to ensure compliance with statute.

Auditors contacted six states that regulate gaming, racing, and/or boxing and mixed martial arts—Alabama, California, Florida, Nevada, New Mexico, and Utah—and found that none used private enterprises to meet similar objectives and purposes.

## **2. The Department's effectiveness and efficiency in fulfilling its key statutory objectives and purposes.**

The Department has generally been effective in meeting its key statutory objectives and purposes. Specifically, through comprehensive compliance reviews and ongoing monitoring activities, the Department has conducted adequate oversight of gaming facilities and helped to ensure tribal gaming facility compliance with the Compact. Additionally, by certifying gaming vendors and employees, the Department has helped

ensure that the tribal gaming facilities employ only suitable individuals and businesses. However, the Department should continue its efforts to ensure that gaming employees in management positions, such as gaming facility managers and finance directors, are appropriately identified during the certification process and receive the required financial background checks when applying to renew their certification (see Finding 1, pages 12 through 14).

To meet its statutory purpose to regulate racing, the Department has generally licensed participants appropriately, but it should perform name-based background checks of license applicants through the Federal Bureau of Investigation when fingerprint-based background checks are not feasible, cross-train its licensing staff to complete criminal background investigations and make licensing recommendations and decisions, and continue to track and evaluate its licensing timeliness to ensure it completes criminal background investigations in a timely manner. The Department should also develop and implement policies and procedures that require the supervisory review of all licensing recommendations and decisions the special investigator makes when applicants have criminal history, and develop and implement policies and procedures for conducting interviews, such as what information should be obtained through an interview, to ensure that licensing applicants are evaluated consistently and effectively (see Finding 2, pages 15 through 19).

Additionally, the Department should address the following areas to better meet its statutory objectives and purposes:

- **Update and implement ASET-required IT policies and procedures and conduct a risk assessment to evaluate, document, and prioritize the areas in the Department's IT systems with the highest security risks**—Arizona state agencies are required to develop IT security-specific policies and procedures consistent with ASET's state-wide policy. ASET's policy is intended to help state agencies implement recommended IT security best practices and to protect the State's IT infrastructure and the data contained therein. Auditors reviewed the Department's IT systems and controls and found that the Department generally has good IT security and controls, such as processes for conducting regular scans of its IT systems to identify and remediate vulnerabilities in these systems. Additionally, the Department has implemented a secure email system that gives the Department the ability to exchange documents, such as certification and licensing applications securely with external users. However, the Department's IT policies and procedures do not include adequate detail regarding several IT security processes. For example, as of April 2018, the Department had not developed written procedures for regularly reviewing IT system hardware and software updates, establishing a plan to apply them, and applying them as appropriate.

Additionally, the Department has not conducted a formal risk assessment of its IT systems to identify the systems with the highest security risks. A risk assessment is a structured process that identifies IT system risks within an organization, such as weak security practices, outdated systems, or the lack of a plan for restoring IT following a disaster, and determines what controls are needed to lessen these risks. Therefore, the Department should conduct a risk assessment to evaluate, document, and prioritize the areas in the Department's IT systems with the highest security risks. Then, the Department should use that information to guide its efforts to develop and implement all necessary security program policies and procedures in line with IT standards, best practices, and ASET standards, focusing on high-risk areas first.

- **Finalize tote audit manual**—The Department is required by rule to test the totalisator (tote) system, which records the amounts of money wagered for each horse race, computes the odds and estimated payoff associated with each horse race, and calculates the payouts to the wagering public, the racetrack, and the State. The tote system is required to be tested prior to the first live race meet of the racing season. The purpose of the test is to verify the correct rates, odds, and pricing for wagering locations. The Department has developed some draft policies and procedures for testing the tote system and, based on auditors' observation, the Department appropriately follows rule by testing the tote system prior to the first live race meet and follows its draft policies and procedures for conducting the tote system audit. However, the Department's draft policies and procedures lack adequate detail for some key tote

audit aspects, such as verifying test data, which are the results of the tote system tests. For example, the Department utilizes spreadsheets that incorporate calculations from rule for betting scenarios, but there is no mention in the draft policies and procedures for how these spreadsheets are used to both conduct the tote system test and to verify the test data. Similar recommendations were included in the 2007 Office of the Auditor General performance audit and sunset review of the Arizona Department of Racing. Specifically, the 2007 performance audit report identified that the Arizona Department of Racing should complete the development of a tote system testing policies and procedures manual and implement it. However, the Auditor General's August 2009 followup to the 2007 performance audit report noted that the Arizona Department of Racing had not finalized a policies and procedures manual. Therefore, the Department should add supplementary detail to and finalize its policies and procedures for conducting tote audits, such as information on verifying test data, to ensure staff have adequate guidance when auditing the tote system.

- **Improve internal controls regarding capital assets, compliance with Arizona conflict-of-interest laws, and its financial management of the Arizona Benefits Fund**—According to an Office of the Auditor General June 2018 procedural review (see Report 18-303), the Department should address deficiencies in three areas to ensure it fulfills its responsibility to establish and maintain adequate internal controls. Specifically, the Department should:
  - **Comply with the State's capital assets policies and procedures**—The Department did not have sufficient internal controls in place to properly control, safeguard, and report its capital assets. Specifically, the Department had no record of when it last performed a physical inventory of its capital assets or reconciled its internal capital assets listing to the State's Fixed Asset Module (FAM), as required by the State of Arizona Accounting Manual (SAAM). Additionally, 5 of the 22 capital assets auditors tested had been disposed of or transferred to another state agency, and the Department had not removed these assets from the FAM in a timely manner. Without effective internal controls, the Department's capital assets are exposed to loss, theft, or misuse. Therefore, the Department should conduct a physical inventory of its capital assets, update its internal capital assets listing and the FAM for any changes, and perform a reconciliation between its internal listing and the FAM at least annually. In addition, a record documenting the physical inventory should be prepared and retained for the retention period established by the Arizona State Library, Archives and Public Records.
  - **Maintain accurate and up-to-date conflict-of-interest forms**—The Department did not have adequate internal controls to ensure that all department employees in management positions disclosed potential conflicts of interest. Specifically, the Department did not maintain conflict-of-interest disclosure forms for three of five employees in management positions that were tested. As a result, there is a risk that a conflict of interest existed, and expenditures may have occurred that resulted in employee personal gain or were otherwise inappropriate. Further, the Department may fail to report related-party transactions to the State Comptroller for financial reporting purposes. The Department should maintain accurate and up-to-date conflict-of-interest disclosure forms for all employees to help ensure compliance with A.R.S. §38-503. Further, as required by the SAAM, if the Department has related-party transactions that aggregate to \$100,000 or more annually, it should report them to the State Comptroller for financial reporting purposes.
  - **Improve financial management of the Arizona Benefits Fund**—The Department did not maintain effective financial management over the Arizona Benefits Fund, which consists of tribal gaming contributions Indian tribes pay to the State. Specifically, auditors noted that the Department comingled unspent monies allocated for reimbursement of the Department's administrative and regulatory expenses for gaming regulation with unspent monies allocated for problem gambling activities. The Department could not separately identify these unspent monies in the State's accounting information system and, as a result, risks spending these monies in violation of state laws. Therefore, the Department should improve its financial management of the Arizona Benefits Fund by identifying and accounting for monies designated for the reimbursement of administrative and regulatory expenses for gaming regulation separately from monies designated for problem

gambling initiatives in the State's accounting information system. Additionally, the Department should review prior years' allocations and expenditures to help identify accurate amounts of unspent monies available to reimburse administrative and regulatory expenses and for problem gambling initiatives.

Finally, auditors identified an additional finding regarding the Department's administration of the Arizona Benefits Fund. This finding contained sensitive information, and therefore, the finding and associated recommendations were communicated directly to department management.

**3. The extent to which the Department serves the entire State rather than specific interests.**

The Department serves the entire State by ensuring that the various tribal gaming facilities located throughout the State adhere to the Compact, regulating horse racing at two tracks and various county fairs, and ensuring that off-track betting locations around the State comply with statutes and administrative code. Additionally, the Department examines gaming facility records to ensure tribal gaming offices are remitting the correct amounts of gaming revenues to the State and local governments, as outlined in the Compact. Further, the Department provides outreach, training, and support for those in Arizona with gambling problems. The Department also has a website where the public can obtain information about activities the Department regulates. For example, members of the public can obtain a list of treatment providers for problem gambling, licensing information for those involved in horse racing, and application forms for boxing and mixed martial arts participants on the Department's website.

**4. The extent to which rules adopted by the Department are consistent with the legislative mandate.**

A.R.S. §5-601(E) exempts the Department from the rulemaking requirements of A.R.S. Title 41, Ch. 6, and the Department has not established any rules. The Compact establishes the regulations for tribal gaming in Arizona. The Department does not have express statutory authority to adopt rules for regulating horse racing in Arizona, and instead follows the rules established by the Racing Commission (see Introduction, page 6, for more information).

**5. The extent to which the Department has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.**

As noted previously, the Department is exempt from rulemaking requirements and has not adopted rules. Therefore, the Department has not needed to solicit or encourage input from the public before adopting rules.

The Department informs the public of its activities and actions and their expected impact on the public through its website, news releases, published articles, and annual reports. For example, the Department has a Quick Links section on its website that provides the public with access to a Frequently Asked Questions page as well as informational videos that contain general information about the Department's regulatory activities.

**6. The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction.**

The Department has authority to investigate and resolve tribal gaming complaints related to compact noncompliance, but the Tribal Gaming Office for each tribe is responsible for resolving complaints regarding wins and losses from gambling at gaming facilities. For example, if a patron reports to the Department that a slot machine did not issue a proper payout, the Department will verify that the machine is in proper working order. However, department staff direct the patron to the Tribal Gaming Office to resolve the payout issue. In fiscal year 2017, the Department received 20 patron complaints.

Similarly, according to rule, the Department can investigate and resolve complaints against a horse racetrack official, an employee of a permittee, or a licensee.<sup>31</sup> The Department's complaint process allows

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<sup>31</sup> Arizona Administrative Code R19-2-121(D)(1).

submissions of complaints by mail, fax, or email. The Department will issue a written response to the complainant acknowledging receipt of the complaint and conduct an investigation, as appropriate. As part of its authority to regulate horse racing in Arizona, the Department may take various actions based on a complaint investigation and a determination of whether a statutory violation occurred, such as imposing fines of up to \$2,500, suspending a license for up to 6 months, or revoking a license based on the severity of the violation. In fiscal year 2017, the Department reported that it received four complaints within its jurisdiction, including one complaint regarding a license denial. According to the Department, it took between 7 and 41 days to resolve the four complaints.

**7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under the enabling legislation.**

The Department has the authority to and has entered into an intergovernmental agreement with the Attorney General's Office for legal services, according to A.R.S. §§5-602(I) and 11-952. The Attorney General's Office has the authority to take action against the tribes for compact violations and to represent the Department in administrative hearings regarding gaming certifications. In addition, statute authorizes the Attorney General's Office to represent the Department and prosecute individuals in violation of racing statutes and rules.<sup>32</sup>

**8. The extent to which the Department has addressed deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.**

Although the Department reported that it has not identified deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate, the following statutory changes have been made that impact its responsibilities:

- Laws 2015, Ch. 19, merged the Arizona Department of Racing with the Department, which expanded the Department's responsibilities, including the regulation of pari-mutuel horse racing and wagering, and providing staff support to the Boxing and MMA Commission;
- Laws 2015, Ch. 267, allowed racing permittees to submit a written contract to the Department to permit simulcast racing at the same time live races take place; and
- Laws 2016, Ch. 246, prohibited live dog racing in Arizona after December 31, 2016.

**9. The extent to which changes are necessary in the laws of the Department to adequately comply with the factors listed in the sunset law.**

Auditors identified one area where the Legislature should consider making a statutory change. As noted in the Introduction (see page 6), the Department provides staff support to the Boxing and MMA Commission. In addition, the Department works in conjunction with the Racing Commission to regulate horse racing in the State. However, each of these entities has a separate sunset date. Specifically, the Department's sunset date is July 1, 2020; the Racing Commission's sunset date is July 1, 2024; and the Boxing and MMA Commission's sunset date is July 1, 2026. The sunset date is established to ensure that the purpose and functions of state agencies are reviewed and to determine whether changes are warranted. By aligning the sunset dates of these three entities, the Legislature could more effectively and in a timely manner evaluate and address the collective regulation of gaming, racing, and boxing and mixed martial arts in the State. Therefore, the Legislature should consider aligning the sunset dates of the Department, the Racing Commission, and the Boxing and MMA Commission.

**10. The extent to which the termination of the Department would significantly affect the public health, safety, or welfare.**

Terminating the Department could affect the public's health, safety, and welfare if its regulatory responsibilities were not transferred to another entity. The Department's regulatory authority for tribal gaming is expressed

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<sup>32</sup> A.R.S. §41-192(A)(1).

in the Compact. The Department is responsible for helping ensure the appropriate conduct and oversight of gaming in the State and supporting problem gambling prevention, treatment, and education to individuals with gambling problems. Specifically, department staff certify gaming employees and vendors, inspect gaming facilities to ensure compliance with compact-directed health and safety requirements, ensure gaming machines are operating in compliance with the Compact, and investigate illegal gambling. Additionally, the Department, in conjunction with the Racing Commission, regulates horse racing throughout the State. Specifically, the Department is responsible for licensing all racing participants to ensure they comply with rules and statutes governing horse racing and conducting inspections of race tracks to ensure race meets are conducted in a manner that is safe for all participants. Finally, the Department provides staff support to the Boxing and MMA Commission, without which the Commission would need to hire its own staff. These department staff are responsible for duties such as ensuring boxing and mixed martial arts matches are conducted between evenly matched fighters, processing licenses for all participants, and ensuring match contestants have submitted required medical screening information.

**11. The extent to which the level of regulation exercised by the Department compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.**

Auditors found that the Department provides a similar level of regulation for gaming and racing as compared to other states. Auditors compared specific regulatory aspects of gaming and racing to other states and found the following:

- **Gaming**—The Department is the regulatory authority for tribal gaming in the State, which includes games such as slot machines, house-banked poker, and blackjack. Games such as roulette, craps, and baccarat are not allowed in Arizona. Auditors contacted the gaming authorities in five other states—California, Florida, Nevada, New Mexico, and Utah—to compare Arizona’s level of regulation across the following areas:<sup>33,34</sup>
  - **Employee certification**—Three of the four states that allow gambling—California, New Mexico, and Nevada—certify or license gaming facility staff to ensure suitability for employment. Like Arizona, these states review areas such criminal history, employment, and financial history.
  - **Inspections**—Three of the four states that allow gambling—California, Florida, and Nevada—conduct periodic inspections of gaming facilities to ensure compliance with their respective compacts and/or regulations.<sup>35</sup> These states perform inspections similar to Arizona, determining whether gaming facility surveillance measures are in compliance with gaming compacts and/or legal requirements, and whether table games and gaming machines are operating in alignment with industry and compact standards and/or legal requirements.
  - **Gaming facility audits**—All four states that allow gambling—California, Florida, Nevada, and New Mexico—either conduct annual audits of gaming facilities or mandate that annual audits be conducted by an independent certified public accountant (CPA). Similar to Arizona, all four states either review or require an independent CPA to review financial information to ensure that gaming facilities are operating in alignment with state law and/or tribal gaming compacts. These audits include reviewing gaming facility revenues to determine and verify the accuracy of tribal contributions to the State.
- **Racing**—The Department, along with the Racing Commission, regulates pari-mutuel racing and wagering conducted in Arizona. Auditors contacted the racing authorities in five other states—California, Florida, Nevada, New Mexico, and Utah—to compare Arizona’s level of regulation across the following areas:<sup>36</sup>

<sup>33</sup> Auditors selected these states because they had previously been contacted for information regarding racing regulation.

<sup>34</sup> Utah allows boxing, mixed martial arts, and horse racing, but gambling is illegal in all forms.

<sup>35</sup> California, Florida, and New Mexico’s regulations for tribal gaming in their respective states are contained in compacts. Nevada’s tribal gaming regulations are contained in statute.

<sup>36</sup> Auditors selected states where the regulatory body for racing was part of a larger government agency or where there was significant activity in the industry.

- **Licensing**—Similar to Arizona, license applicants in California, Florida, Nevada, and New Mexico submit fingerprint cards for background investigation purposes.<sup>37</sup> Applicants in Arizona and Nevada submit fingerprints at least once every 2 years, while applicants in California and Florida must submit fingerprints once every 3 years, and applicants in New Mexico must submit fingerprints once every 6 years.

As noted in Finding 2, page 16, the Department issues temporary licenses to applicants that become permanent after 90 days. Similarly, California, Florida, Nevada, and New Mexico also issue temporary licenses to applicants.<sup>38</sup> For example, Florida issues temporary occupational licenses that are valid for no more than 90 days. Like Arizona, all five states have the authority to grant, suspend, or revoke licenses and impose fines.

- **Inspections**—Each state investigates licensee activities upon the premises of racetracks or pari-mutuel wagering facilities. Four of five states—California, New Mexico, Nevada, and Utah—conduct inspections of racing facilities at least once a year. The Department conducts monthly inspections of the Turf Paradise racetrack in Arizona during its race dates, which run from October through May. Additionally, the Department conducted an inspection of the Rillito Park Racetrack during the 2018 racing season, which ran from mid-February 2018 through mid-March 2018.

In addition, auditors found that Arizona’s regulatory structure for racing generally differs from the other states auditors contacted. As mentioned in the Introduction (see page 6), the Department, in conjunction with the Racing Commission, is responsible for the regulation and oversight of pari-mutuel horse racing and wagering conducted on-and-off track in Arizona. In contrast to Arizona, four of the five states that auditors contacted—California, Florida, New Mexico, and Utah—have a single agency responsible for regulating all aspects of horse racing, which includes licensing racing participants and adopting racing rules and regulations. Of the five states auditors contacted, only Nevada is similar to Arizona in that Nevada has two entities that share regulatory responsibility for horse racing. Specifically, Nevada’s Gaming Control Board conducts investigations of licensees and activities at the racetracks, processes licensing applications, and enforces racing laws and regulations at racing meetings, whereas the Nevada Gaming Commission is the final approving authority on the recommendations of the Nevada Gaming Control Board, such as licensing decisions and disciplinary actions against licensees, and is responsible for adopting laws and regulations for racing.

Finally, auditors compared the regulatory structure of boxing and mixed martial arts in Arizona to five other states—Alabama, California, Florida, Nevada, and Utah—and found that Arizona’s regulatory structure is generally similar to these states.<sup>39</sup> As noted in the Introduction (see page 6), the Department provides staff support to the Boxing and MMA Commission, which is the sole entity responsible for regulating all professional boxing and mixed martial arts events conducted in Arizona. Like Arizona, all five states that auditors contacted have a single commission responsible for regulating professional boxing and mixed martial arts. Additionally, these states license individuals involved with boxing and mixed martial arts matches, such as contestants and referees. However, auditors found that other state commissions’ staffing varies by state. For example, the Alabama State Athletic Commission is a stand-alone agency with its own staff, whereas the Utah Athletic Commission is part of the Utah Governor’s Office of Economic Development and its staff are employed by the Office of Economic Development.

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<sup>37</sup> Auditors did not identify any fingerprint card requirements for background investigation purposes for racing license applicants in Utah’s regulations.

<sup>38</sup> Auditors did not identify the practice of issuing temporary licenses to racing license applicants in Utah’s regulation requirements.

<sup>39</sup> Auditors selected states where the regulatory body for boxing and mixed martial arts was part of a larger government agency or where there was significant activity in the industry.

## 12. The extent to which the Department has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.

Although the Department does not use private contractors to regulate tribal gaming, it uses several private contractors to help with other responsibilities, and auditors did not identify any opportunities for the Department to make additional use of private contractors. For example, the Department contracts with private counselors and psychologists to treat individuals for problem gambling and to provide helpline services and education to the public about problem gambling. Additionally, the Department uses contracted inspectors and stewards, who are race meet officials, to help regulate horse race meets. The Department also contracts with a private laboratory to perform all human and animal testing for horse racing. For example, the Department's contracted private laboratory analyzes blood and urine samples taken from horses immediately after races to determine if a horse has been drugged. Finally, the Department contracts with a private veterinarian for the Rillito Park Racetrack and county fairs, who is in charge of all sample collection and who has the authority to suspend horses from racing if he/she believe the horse is unsafe, unsound, or unfit.

Auditors contacted gaming regulatory authorities in four states—California, Florida, Nevada, and New Mexico—to determine to what extent private contractors are used to regulate gaming. Similar to Arizona, none of the states contacted use private contractors to regulate gaming. However, three states—California, Florida, and Nevada—pay private contractors to provide support services for those with gambling problems.

Finally, auditors contacted the racing regulatory entities in five states—California, Florida, Nevada, New Mexico, and Utah—to determine to what extent these entities used private contractors in performing their duties. California uses contractors for all steward positions and all official veterinarians. Similar to Arizona, Florida contracts for blood and urine analysis for human and animal testing. Nevada uses a contractor for their state veterinarian position, who is responsible for duties such as providing proper safeguards for laboratory samples and inspecting horses. Utah uses a contractor to license racing participants and additionally contracts with a nonprofit racing organization to facilitate horse races. New Mexico uses several contractors for veterinarian positions, an equine medical director, court reporters, and hearing officers.

### Recommendations

The Department should:

1. Conduct an IT risk assessment to evaluate, document, and prioritize the process areas in the Department's IT systems with the highest security risks.
2. Use the information from the IT risk assessment to guide its efforts to develop and implement all necessary security program policies and procedures in line with IT standards, best practices, and ASET standards, focusing on high-risk areas first.
3. Add supplementary detail to and finalize its policies and procedures for conducting tote audits, such as information on verifying test data, to ensure staff have adequate guidance when auditing the tote system.
4. The Department should implement the recommendations from the Office of the Auditor General's June 2018 procedural review, conducted in conjunction with this audit (see Report 18-303). Specifically, the Department should:
  - Conduct a physical inventory of its capital assets, update its internal capital assets listing and the FAM for any changes, and perform a reconciliation between its internal listing and the FAM at least annually. In addition, a record documenting the physical inventory should be prepared and retained for the retention period established by the Arizona State Library, Archives and Public Records.
  - Maintain accurate and up-to-date conflict-of-interest disclosure forms for all employees to help ensure compliance with A.R.S. §38-503. Further, if the Department has related-party transactions that aggregate to \$100,000 or more annually, it should report them to the State Comptroller for financial reporting purposes.

- Improve its financial management of the Arizona Benefits Fund by identifying and accounting for monies designated for the reimbursement of administrative and regulatory expenses for gaming regulation separately from monies designated for problem gambling initiatives in the State's accounting information system. Additionally, the Department should review prior years' allocations and expenditures to help identify accurate amounts of unspent monies available to reimburse administrative and regulatory expenses and for problem gambling initiatives.

The Legislature should:

5. Consider aligning the sunset dates of the Department, the Arizona Racing Commission, and the Arizona Boxing and Mixed Martial Arts Commission.





## Tribal-State Gaming Compact description

**Table 2**  
Description of Tribal-State Gaming Compact (Compact) sections and appendices

Section/Appendix	Description
Sections 1 & 2	Describes the compact document and the definitions that are used in the Compact and its appendices.
Section 3	Outlines the nature, size, and conduct of class III gaming, including authorized class III activities. This includes the number of gaming devices/gaming tables and gaming facilities allowed; inter-tribal parity provisions; notice required by the tribe or the State to the other before invoking provisions of the Compact related to limits on the number of gaming machines and table games, and tribal contributions to the State; restrictions on location of gaming facilities; restrictions on certain financial services in gaming facilities; allowed forms of payment for wagers; wager limitations for games; hours of operation; ownership of gaming facilities and gaming activities; prohibition on firearms; financing regulation; surveillance recordkeeping; barred persons regulations; problem gambling regulations; restrictions on minors; internet gaming regulations; and prohibition on tribal lotteries competing with the Arizona lottery.
Section 4	Covers tribal-state licensing and certification requirements, including specific requirements for gaming facility operators and gaming facilities; gaming employees; management contractors; manufacturers and distributors of gaming devices; and suppliers of gaming services.
Section 5	Covers procedures for tribal licensing and state certification.
Section 6	Outlines tribal regulation related to compact provisions, including responsibilities of the tribal gaming office and gaming facility operator; responsibilities and composition of tribal gaming office staff and executive directors; right of inspection; reporting of violations; investigation requirements; and reporting requirements to the Arizona Department of Gaming (Department).
Section 7	Details department monitoring of compact provisions, including specific department monitoring provisions; access to tribal gaming records and confidentiality requirements; retention of records; tribe's access to state gaming regulation records; notification requirements to tribal gaming offices; cooperation requirements with tribal gaming offices; compact compliance review authorization; and allowed remedies for the Department to enforce compact requirements.
Section 8	States that nothing in the Compact is intended to change, revise, or modify the civil and criminal jurisdiction of the tribe or the State. In addition, nothing in the Compact shall limit existing federal jurisdiction over Indians and gaming operations authorized under the Compact.
Section 9	Allows a cross deputization agreement between state and tribal gaming law enforcement officials.
Section 10	Allows the Department and the tribal gaming office to enact rules consistent with the Compact, pursuant to their rulemaking authority.

**Table 2 (continued)**

Section/Appendix	Description
Section 11	Details operational requirements the gaming facility operator must maintain, including an internal control system; internal control system and standards review; accounting and financial records; bank account requirements; and annual audit requirements.
Section 12	Covers payment of regulatory costs and tribal contributions, including payment of regulatory costs by the tribes to the State; tribal contributions to the State from the tribe's class III win; creating the Arizona Benefits Fund to facilitate tribal contributions to the State; distribution requirements to cities, towns, and counties; contribution schedule; provisions for reducing tribal contributions; report and audit guidelines; and provisions for transitional funding.
Section 13	Addresses public health, safety, and welfare, including health and safety compliance requirements; emergency medical and fire suppression services requirements; tort remedies for patrons; liability for damages to persons and property; law enforcement requirements; and maintenance of plans and procedures.
Section 14	Includes procedures for investigating and reviewing decisions involving patron disputes.
Section 15	Outlines procedures for dispute resolution, including necessary notice and negotiation; mediation guidelines; arbitration guidelines; and injunctive relief guidelines.
Section 16	Covers reservation of rights under the Compact, including the status of class I and class II gaming; prohibition on taxation by the State; preservation of tribal self-government; use of net revenues; and tax documentation the tribe must provide the Department.
Section 17	Details the compact amendment process.
Section 18	States the severability of the Compact's various provisions.
Section 19	Specifies that the Compact is entered into solely for the benefit of the tribes and the State.
Section 20	Contains guidelines for how the Compact's parties will provide notices to each other.
Section 21	Covers the calculation of time for purposes of the Compact. For example, if a requirement is to be completed in 11 days or less, weekends and holidays are excluded from the computation period.
Section 22	Details who shall maintain original copies of the Compact.
Section 23	Explains the effective date and duration of the Compact.
Section 24	States that the Compact shall be governed by applicable laws of the United States, the tribe, and the State.
Section 25	States that the Compact contains the entire agreement of the parties and no other statement, agreement, or promise shall be valid or binding.
Section 26	Outlines the authority to execute the Compact and includes signature sections for the tribes, the Arizona state governor, and the U.S. Secretary of the Interior.
Appendix A	Covers specific technical standards for gaming devices, components, software, and progressive gaming devices.
Appendix B	This is the tribal gaming ordinance document. There is a unique ordinance for each tribe.
Appendix C	Covers specific security and surveillance requirements.
Appendix D	Definitions, operational standards, specifications, and regulations governing keno.
Appendix E	Definitions, operational standards, specifications, and regulations governing pari-mutuel wagering centers.
Appendix F	F1 covers definitions, operational standards, specifications, and regulations governing blackjack. F2 covers definitions, operational standards, specifications, and regulations governing jackpot poker.

**Table 2 (continued)**

Section/Appendix	Description
Appendix G	Definitions, operational standards, specifications, and regulations for lottery and requirements for promotions.
Appendix H	Outlines minimum internal control standards and states that the standards shall apply to all gaming facility operators and gaming facilities.
Appendix I	Outlines how Class III Net Win revenue is to be reported to the State for all games and gaming devices in the casinos.
Appendix J	Outlines how to process vendor certifications.

Source: Auditor General staff review of the Compact.





## Methodology

Auditors used various methods to review the issues in this performance audit and sunset review. These methods included reviewing Arizona Department of Gaming (Department) statutes, rules, annual reports, policies and procedures, and information from the Department's website; interviewing department staff and stakeholders; and observing various department processes.

In addition, auditors used the following specific methods to meet the audit's objectives:

- To obtain information for the report Introduction, auditors reviewed department-prepared documents relating to its responsibilities, functions, and staffing. Additionally, auditors reviewed the Tribal-State Gaming Compact (Compact), documentation from 11 compact compliance reviews (CCRs) the Department conducted in 2016 and 2017, observed an on-site review of a gaming facility in November 2017, analyzed the Department's standardized CCR audit program, and reviewed CCR checklists, manuals, guides, and tracking reports. Additionally, auditors observed gaming facility routine inspections, observed staff review of tribal incident reports (TIRs), and reviewed the TIR database system and reports. Auditors also reviewed the Department's procedures manual and reviewed all tribes' 2016 external financial audits. Finally, auditors compiled and analyzed unaudited information from the Arizona Financial Information System *Accounting Event Transaction File* and the State of Arizona *Annual Financial Report* for fiscal years 2015 through 2017, and department-prepared estimates for fiscal year 2018.
- To determine if the Department appropriately certified tribal gaming facility vendors and employees, auditors reviewed all 3 class A, all 3 class B, and a random sample of 4 of the 74 class D new vendor certifications issued in fiscal year 2017, and a random sample of 5 of the 231 total vendor certification renewals issued between October 1, 2016 and June 30, 2017. Lastly, auditors reviewed a random sample of 10 nonmanagement and 5 key and sensitive management position (SMP) certifications of the 1,104 initial employee certifications and 10 nonmanagement and 5 key and SMP certifications of the 4,155 renewal employee certifications submitted during fiscal year 2017.
- To determine if the Department issued racing licenses to qualified applicants in a timely manner, auditors reviewed a random sample of 30 of the 3,101 jockey, groom, exercise rider, trainer, owner, and occupational licenses the Department issued between July 2015 and June 2017. In addition, auditors analyzed department data for the 1,154 racing licenses processed between August 2017 and March 2018. Auditors also reviewed the Department's licensing applications and compared them to statute and rules.
- To obtain information for the Sunset Factors, auditors contacted and reviewed the statutes and/or rules for the horse racing authorities in five other states—California, Florida, Nevada, New Mexico, and Utah—and contacted and reviewed the statutes and/or rules for the gaming authorities in five other states—California, Florida, Nevada, New Mexico, and Utah.<sup>40,41</sup> Additionally, auditors contacted and reviewed the statutes and/or rules for the boxing and mixed martial arts authorities in five other states—Alabama, California, Florida, Nevada,

<sup>40</sup> Auditors selected states where the regulatory body for racing was part of a larger government agency or where there was significant activity in the industry. Auditors selected the same states for gaming regulation because they had previously been contacted for information regarding racing regulation.

<sup>41</sup> Utah allows boxing, mixed martial arts, and horse racing, but gambling is illegal in all forms.

and Utah.<sup>42</sup> To determine if the Department had an adequate information technology (IT) security program and related policies and procedures, auditors interviewed department staff and analyzed the Department's IT security-related policies and other documents and compared them to state-wide requirements from the Arizona Department of Administration, Arizona Strategic Enterprise Technology Office.

- Auditors' work on internal controls included reviewing the Department's policies and procedures for ensuring compliance with the Compact, and department statutes and Arizona Racing Commission rules; where applicable, testing the Department's compliance with these policies and procedures; and observing department staff performing tribal contribution review activities. Auditors also reviewed the Office of the Auditor General's June 2018 procedural review of the Department's internal controls related to cash receipts, cash disbursements, travel, payroll, capital assets, transfers, information technology access controls, and compliance with certain Arizona Revised Statutes. Auditors report their conclusions on these internal controls as well as the Department's need to improve its internal controls in Findings 1 and 2, as well as Sunset Factor 2.

Auditors conducted this performance audit and sunset review of the Department in accordance with generally accepted government auditing standards. The 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Auditor General and staff express their appreciation to the Department and its Director and staff for their cooperation and assistance throughout the audit.

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<sup>42</sup> Auditors selected states where the regulatory body for boxing and mixed martial arts was part of a larger government agency or where there was significant activity in the industries.

# AGENCY RESPONSE



August 15, 2018

Ms. Lindsey Perry, Auditor General  
State of Arizona Office of the Auditor General  
2910 N. 44<sup>th</sup> Street, Suite 410  
Phoenix AZ 85018

Re: Response to the August 2018 Performance Audit.

Dear Ms. Perry:

The Arizona Department of Gaming (“ADG” or “Department”) appreciates the opportunity to respond to the recommendations and findings of the performance audit performed by the Office of the Auditor General.

Below, please find the Department’s response to the audit findings.

**Recommendation 1.1: The Department should continue its efforts to ensure that all SMP employees are properly identified and classified to ensure they receive the required expanded financial background check at the time of renewal.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. Although no applicable Tribal-State Gaming Compact requirement exists, the Department will continue its efforts to ensure the proper identification and classification of SMP employees for expanded financial background check purposes.

**Recommendation 1.2: The Department should incorporate the changes it has made to identify SMP employees in its policies, procedures, and/or training manual for employee certification, and then train staff accordingly.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will ensure that it takes the proper steps to incorporate the changes and train staff accordingly.

**Recommendation 2.1: The Department should perform name-based background checks through the FBI, when fingerprint-based background checks are unable to be performed.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. Currently, the Department performs name-based checks on gaming applicants whose fingerprints have been rejected twice by the FBI, as a name-based check cannot be performed until two attempts at fingerprint check has been made first, per DPS policy. The Department will ensure that this

policy is adhered to by the Division of Racing as well, and that name-based checks are requested when necessary and in a timely manner.

**Recommendation 2.2: The Department should cross-train its licensing staff to complete criminal background investigations and make licensing recommendations and decisions.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will work to cross-train licensing staff to complete criminal background investigations, to ensure timely criminal background investigations and licensing.

**Recommendation 2.3: The Department should continue to track and evaluate its licensing timeliness to ensure it completes criminal background investigations in a timely manner.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will continue to track licensing timeliness through the Arizona Management System process.

**Recommendation 2.4: The Department should develop and implement policies and procedures that require the supervisory review of all licensing recommendations and decisions made by the special investigator when applicants have criminal history.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. “Supervisory approval” is currently conducted by the State Racing Stewards in instances where the special investigator determines revocation is appropriate. The Department will ensure that supervisory review occurs for all recommendations and decisions (e.g. no action necessary or revocation) made by the special investigator(s) when applicants have criminal history.

**Recommendation 2.5: The Department should develop and implement policies and procedures for conducting interviews, such as what information should be obtained through an interview, to ensure that licensing applicants are evaluated consistently and effectively.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will ensure that a standardized process is implemented.

**Recommendation 1: Conduct an IT risk assessment to evaluate, document, and prioritize the process areas in the Department’s IT systems with the highest security risks.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department is currently conducting an IT risk assessment to determine these risks.

**Recommendation 2: Use the information from the IT risk assessment to guide its efforts to develop and implement all necessary security program policies and procedures in line with IT standards, best practices, and ASET standards, focusing on high-risk areas first.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

**Recommendation 3: Add supplementary detail and finalize its policies and procedures for conducting tote audits, such as information on verifying test data, to ensure staff have adequate guidance when auditing the tote system system.**

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will work to develop more robust policies and procedures for conducting tote audits.

**Recommendation 4: The Department should implement the three (3) recommendations from the Office of the Auditor General's June 2018 procedural review, conducted in conjunction with the performance audit.**

Response: As stated in the Department's procedural review response letter, the findings of the Auditor General are agreed to and the audit recommendations will be implemented.

- Prior to the end of FY18, the Department completed a physical inventory of all capital assets and updated the internal capital assets list as requested. The Department will continue to do so on an annual basis.
- On July 16, 2018, the Department requested that all employees provide ASPS Disclosure Statement Forms (conflict of interest) to its Human Resources section, pursuant to ARS § 38-503. The Department will conduct annual audits to ensure no deficiencies exist and that all necessary conflict of interest forms are on file.
- The Department will conduct a thorough review of prior years' allocations and expenditures to determine accurate amounts and unspent monies available for problem gambling initiatives. Furthermore, the Department shall determine available options to help identify and track all monies designated for reimbursement of administrative and regulatory expenses separately from monies designated for problem gambling initiatives going forward.

ADG appreciates the input and recommendations of the Office of the Auditor General and looks forward to fully implementing their suggestions in a timely manner. Additionally, the Department believes the outcomes garnered from the audit process will only better the service and safety provided to the Arizona public. Again, on behalf of the Arizona Department of Gaming, I want to thank you for your hard work in compiling such a thorough review.

Sincerely,

Daniel Bergin  
Director

