

Developments/enhancements/maintenance (DEM) Policy

This Policy will provide guidance on developments, enhancements and maintenance (DEM) costs incurred at class 4 gambling venues.

For an outline of the regulatory background to venue costs, including DEM costs, see the Venue Costs Reference Paper: [Reference Paper: Guidelines on Venue Costs Under the Gambling Act 2003](#) and associated FAQ's: [Frequently Asked Questions](#).

Venue costs that may be incurred are restricted by Limits notified in a *Gazette* notice, which also categorises DEM expenditure as a weekly venue cost. A copy of the *Gazette* notice limiting venue costs can be found here: [Gazette Notice: Limits and Exclusions on Class 4 Venue Costs Notice \(17 July 2008\)](#).

Requirements for DEM were further clarified in the Gambling Commission's decision GC10/10, which can be found here: [GC10/10](#). The Department has summarised the decision here: [Key Messages from The Southern Trust and The Trusts Charitable Foundation Gambling Commission Appeals](#).

Key points:

- *only ARN costs may be incurred - any DEM (or other) expenditure that is not ARN is unlawful*
- *using GMP to fund competition cannot be justified*
- *societies must be modest in their spending, and always keep in mind that they are spending money that belongs to the community*
- *the community does not care which society distributes funds, but is interested in making sure that the amount available for distribution is maximized*
- *the Gazette notice requires societies to reflect any DEM costs they incur under Limit C.*

When can DEM costs be incurred?

The responsibility for ensuring that only ARN costs are incurred rests with the society.

Whenever a society is agreeing to DEM expenditure - either as a brand new purchase or a "transferred" cost that another society has agreed to in the past – a full necessity analysis must be conducted. The Department expects societies to read the information contained in the links above, and to make sure that they understand the requirements. The Department may request a copy of the necessity analysis for Compliance or Licensing purposes, and is likely to impose sanctions on societies found to be non-compliant.

The Gambling Commission has defined 'necessary' as "a strong word which has been held by the courts to set a high standard in excess of what might be merely desirable, convenient or reasonable... a fairly strong word falling between expedient or desirable on the one hand and essential on the other".

In line with the requirement for conservatism in the spending of money held in trust for the community, societies must keep in mind that:

- Improvements to the entire venue are not considered necessary to the gambling operation. Any DEM costs incurred must be restricted to the gambling room.
- DEM costs should not be incurred to circumvent a licence condition (such as an access condition).
- The scope of any DEM expenditure must be restricted to what is ARN – if some legitimate DEM expenditure has been identified, it is not acceptable to conduct further associated work such as re-decorating the gambling room unless that work is also ARN.

Key points:

- *the responsibility for compliance rests with the society*
- *ARN requirements are the same regardless of who incurs the cost in the first instance*
- *societies must perform an item-by-item necessity analysis every time they incur DEM costs*
- *costs incurred with the hope or expectation of additional gross revenue are not a necessary cost of gambling*
- *legal requirements suggest societies should spend conservatively, and emphasize protection of funds intended to benefit the community from speculation and waste*
- *any DEM expenditure that is not for remedial work to correct a situation that compromises the conduct of class 4 gambling is not a necessary cost of gambling*
- *necessary DEM expenditure will be rare.*

Who pays for DEM costs, and how are they represented in the Venue Cost schedule?

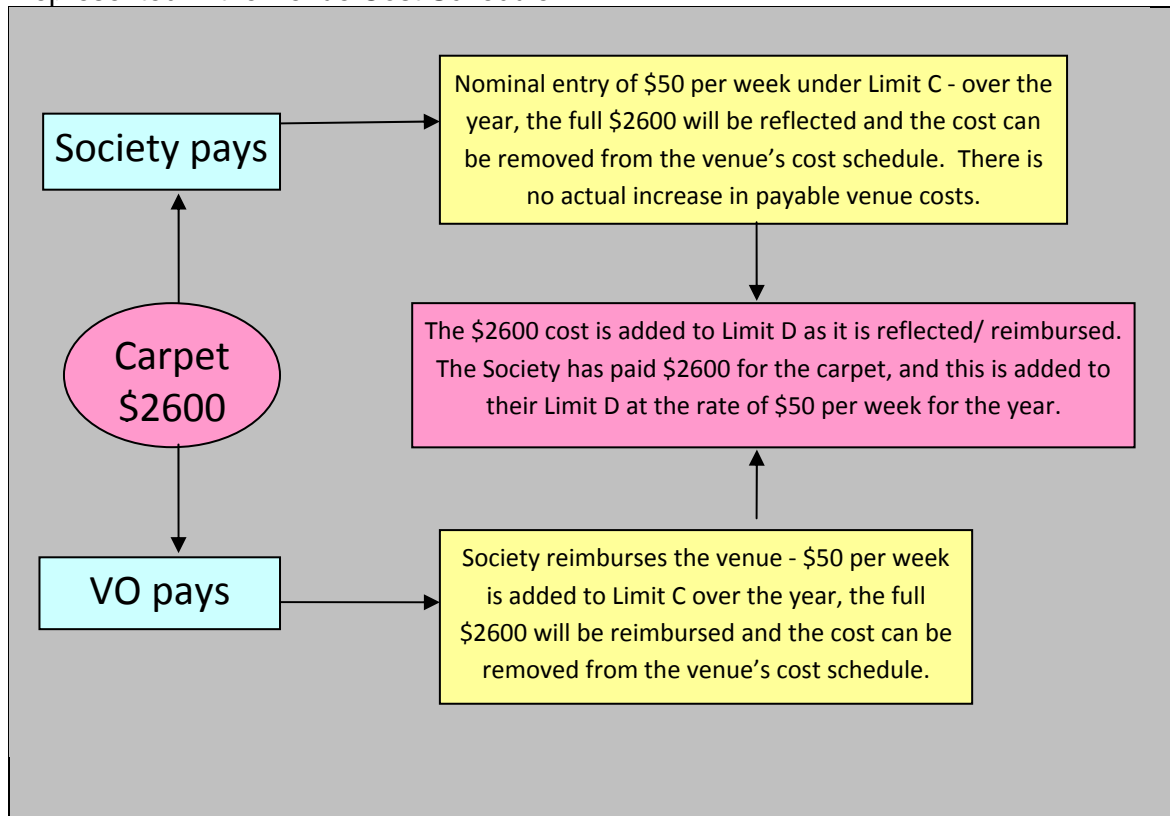
Whether they are new items or items being re-considered when a venue changes society, DEM costs should be incurred by the venue operator in the first instance unless there are exceptional circumstances. DEM costs must be listed under Limit C of the venue cost schedule, and must be added to Limit D as they are reimbursed or reflected under Limit C.

There will be very occasional instances when exceptional circumstances may justify the society incurring DEM costs initially. It is very important that the society retains records and evidence relating to any such decision – i.e. proof of the exceptional circumstances – and the society must be able to produce these on request. Exceptional circumstances are, by definition, very rare.

In cases where the society has paid initially for DEM, there is a serious risk that the community funds used to purchase the DEM could be lost if the venue ceases operating or changes societies. The Department expects societies to ensure that community funds are protected by clearly documenting the venue operator's obligations in terms of any outstanding debt for the DEM costs that have been incurred. For example, the venue operator may be asked to agree to reimburse the society for the unreflected portion of the DEM in the event of their changing societies.

NOTE: The period for reimbursement/ reflection may be agreed by the venue operator and the Society, and can be for any period up to depreciation timeframes. In general, parties are expected to set a shorter period, often over the term of the venue agreement. The reimbursements/ reflections listed under Limit C are added to Limit D every week, contributing to the society's 16% Limit D payment cap.

Below is a flow-chart showing how DEM costs are paid, and explaining how they are represented in the Venue Cost Schedule:



Key points:

- the venue operator must incur costs initially in all but exceptional cases - this is the rule for new DEM and residual DEM that was originally incurred by an outgoing venue operator or society
- If DEM is being reimbursed/ reflected under Limit C, the reimbursed/ reflected amount must be added to Limit D each week
- Societies must be able to make a convincing and auditable case for any decision for the society to incur a DEM cost in the first instance
- in any cases where the society incurs the initial cost for DEM, the society must ensure that the community funds they have used to pay for this cost will be protected if the venue changes societies or ceases operating.

Scenario: Bob's Tavern

Bob is the venue operator at Bob's Tavern, where he hosts 18 gambling machines for Society A. Recently, Bob noticed rips in the carpet around the gaming machines, and he worried that these may be dangerous to his patrons. Bob contacted Society A to request new carpet for the venue.

Society A's first responsibility is to establish whether new carpet is necessary at Bob's Tavern. They send a representative to the venue, who takes photographs and makes an assessment of the current state of the carpet. The assessment and photographs are used to inform a necessity analysis.

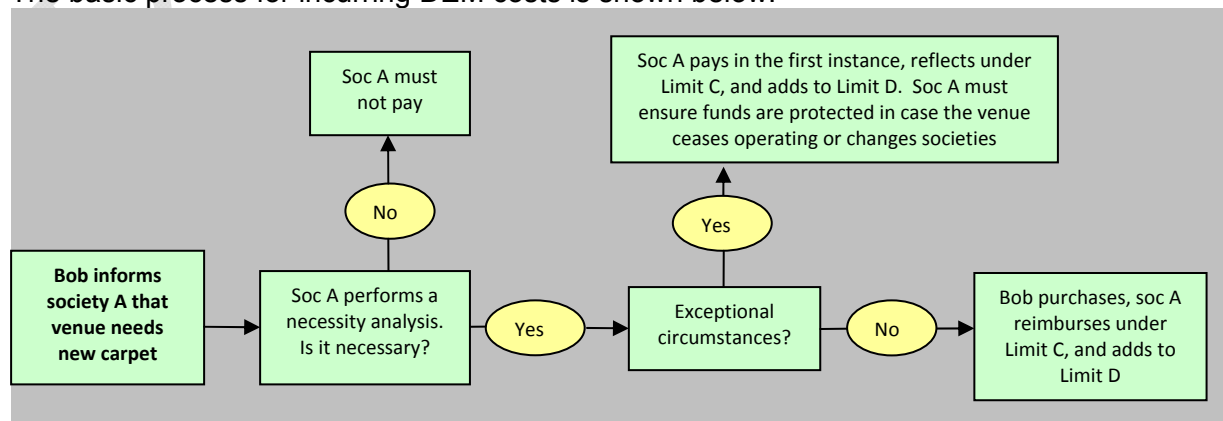
- If it is decided that the costs are not necessary, Society A must not incur them.
- If it is established that the costs are necessary, Society A should source a number of quotes and select the most reasonable. They must ensure that the decision-making processes for assessment of necessity and reasonableness are clearly documented so they are able to provide auditable proof on request.

In this example, Society A's necessity analysis concludes that new gaming room carpet is necessary at Bob's Tavern. The eventual cost of the new carpet is \$2600, and the parties agree to reimbursement/ reflection at \$50 per week over 52 weeks.

Who should pay in the first instance?

- *Venue Operator pays in the first instance.* Bob pays the carpeting provider \$2600 for the new carpet. Society A reimburses Bob for this cost under Limit C of the Venue cost schedule. An additional \$50 per week is listed under Limit C, and \$50 per week is added to Society A's Limit D.
- *Society pays the cost in the first instance.* Bob does not have the funds required to pay for the carpet, and has also been unable to obtain finance. He presents Society A with evidence of this, and Society A decides that this constitutes exceptional circumstances and agrees to pay for the cost in the first instance. They ensure that an auditable record of the decision is available in case it is requested. Prior to any payment being made, Bob signs a legal agreement stating that he will pay Society A for any residual portion of the cost if he ceases operating or changes societies. The cost is reflected under Limit C at \$50 per week, and \$50 per week is added to Society A's Limit D.

The basic process for incurring DEM costs is shown below:



How are DEM costs treated when the venue changes society and/or the venue operator changes?

In cases of society change, incoming societies must treat any existing DEM items as if they were brand new - they must only be agreed to if they meet the requirements set out above. It is emphasised that although another society has deemed an item ARN, the incoming society and operator must make a fresh appraisal. If the appraisal permits the item, only the residual amount (i.e. the amount not yet reflected/reimbursed) must be incurred. Auditable proof of this amount must be retained and supplied to the Department on request.

Where the venue operator changes, the incoming venue operator should purchase the residual value of any ARN DEM items from the outgoing operator or society (depending on who had incurred that cost in the first instance).

Key points:

- *DEM expenditure is treated the same regardless of whether it is a brand new cost or an existing item at a venue experiencing a change of operator or society. Only ARN items can be incurred, and the venue operator must pay in the first instance unless there are exceptional circumstances.*
- *Auditable proof of all decisions must be retained.*

Scenario: Bob changes societies

Bob is not happy with the way Society A handled a recent problem at his venue, so he contacts Society B to request a meeting. After meeting with a representative of Society B, Bob decides he wants to change societies. \$1000 of the total \$2600 have either been reflected (if Society A has paid in the first instance) or reimbursed (if Bob has paid initially).

Society B assesses evidence provided by Bob that the new carpet was necessary.

- If they do not agree that the carpet was necessary, they must not incur the cost, and the residual value must be dealt with by Bob and Society A.
- If they agree that the carpet was necessary, they may decide to take on the reimbursement (scenario 1 below) or reflection (scenario 2) of the cost as appropriate.

Scenario 1 – Venue Operator has paid in the first instance

If Bob has incurred the cost in the first instance, Society B includes the residual amount (i.e. \$1600). Bob and Society B agree on a 32 week period, and so Society B provide for 32 payments of \$50 under Limit C. The 32 payments of \$50 are added to Society B's Limit D as they are incurred.

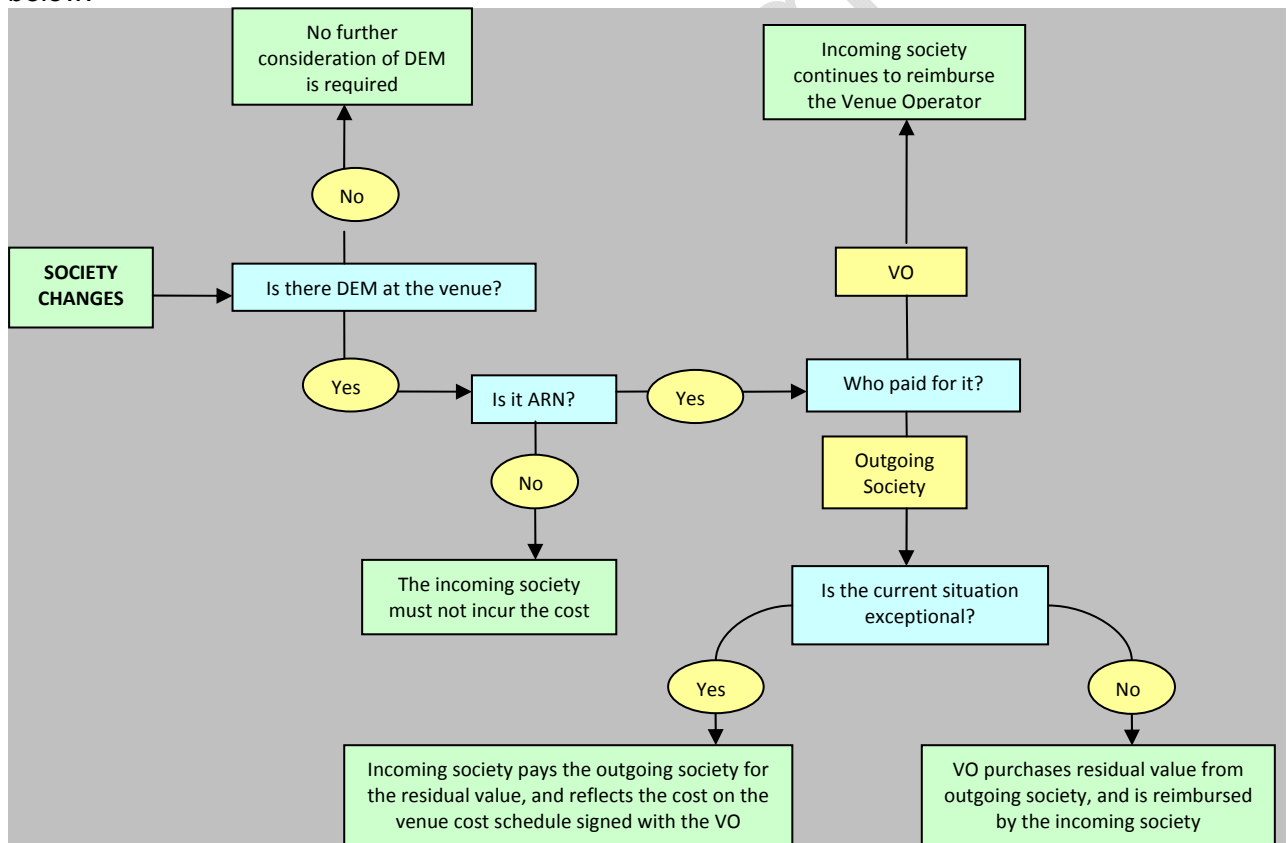
NOTE: If a venue operator has paid for a DEM cost initially, there should be no reconsideration of who pays in the first instance upon a change of society. An incoming society must not pay the residual amount to the Operator in a lump sum and then *reflect* it, though they may *reimburse* the residual in a lump sum under Limits C and D over a short period of time (in many cases DEM could be reimbursed under Limit C in a single week).

Scenario 2 – society has paid in the first instance

Due to the conditions Bob agreed to when the cost was incurred, he is now liable for the outstanding unreflected amount of \$1600. Society A and Bob discuss whether he is now in a position to incur the remainder of the cost in the first instance.

- Bob's financial situation has improved, and he is able to pay Society A the unreflected amount of \$1600. Bob then approaches Society B and asks them to reimburse him for the \$1600 he has paid for the carpet. Society B prefers to reimburse the cost quickly, and they and Bob agree on a shorter reimbursement period – Bob is reimbursed \$100 per week for the next 16 weeks (with \$100 per week added to Society B's Limit D), and the items are then removed from the cost schedule.
- If Bob is still unable to pay Society A for the unreflected amount, Society B may make this payment and continue to reflect the cost only if they can make a convincing case that the circumstances are exceptional (i.e. Bob must supply updated proof to Society B - i.e. evidence that he is still unable to pay or raise credit - to enable them to make an auditable assessment of whether there are exceptional circumstances). Society B reflects \$100 per week for the next 16 weeks (adding \$100 per week to Limit D) and the items are then removed from the schedule.

The treatment of outstanding DEM costs when there is a society change is shown below:

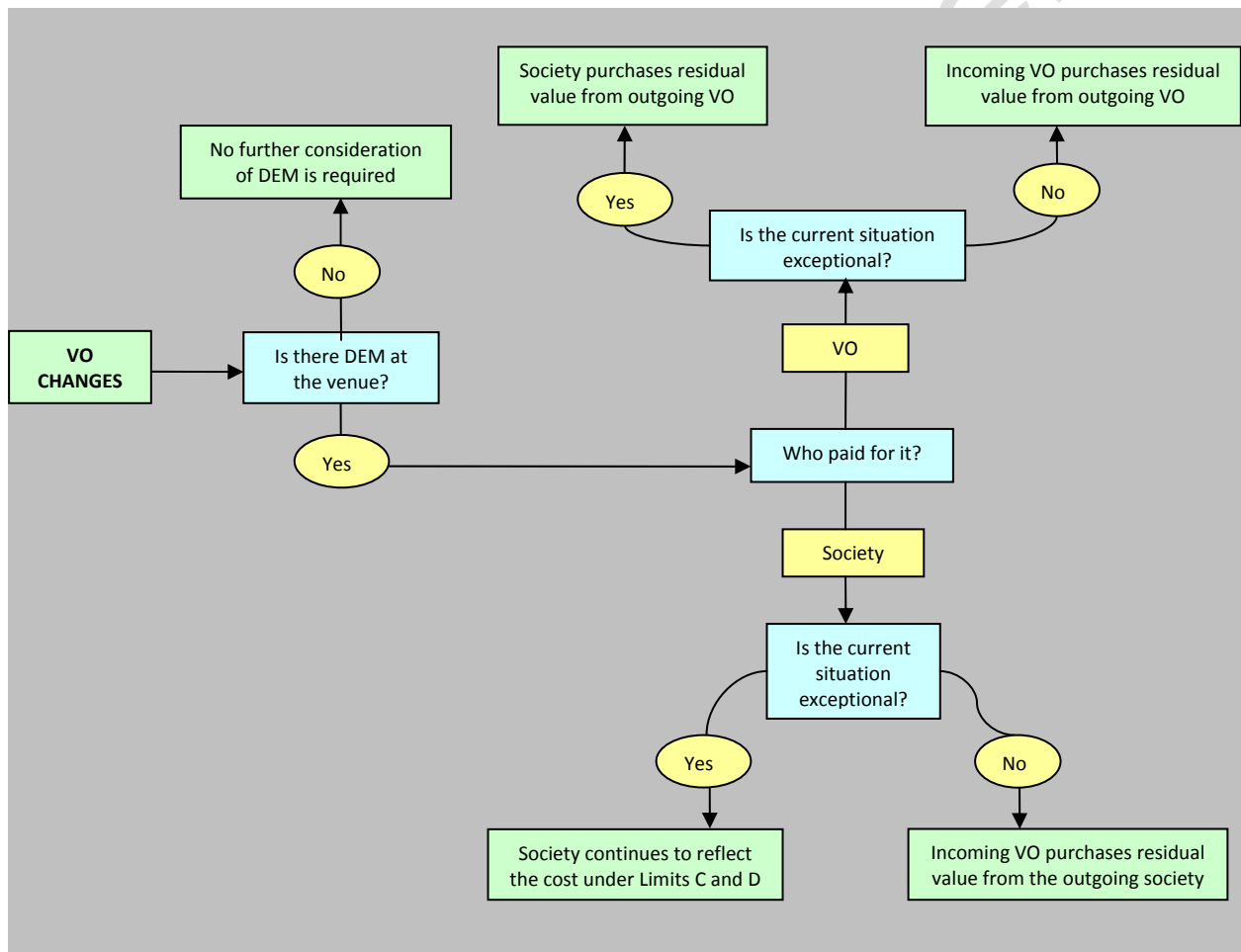


Scenario: Change of venue operator

Bob has decided to retire, so he sells his business to Joan. Joan wants to continue operating with Society B. No necessity analysis is required at this point, as the DEM will not be a new cost to the society, and it is assumed that an auditable necessity analysis has already been performed for the items in question.

- If Society B has incurred the cost in the first instance, they work with Bob to recover the residual amount of DEM that has not yet been reflected under Limits C and D.
- In most cases, Bob will have incurred the cost in the first instance, so he must negotiate with Joan for payment for the remaining \$1600. If Joan picks up the cost, Society B may continue to reimburse her under Limit C (adding the cost to Limit D as it is repaid).
- If Joan is unable to purchase the outstanding DEM, and Society B can make a convincing case for exceptional circumstances, then Society B may decide to purchase the remainder of the DEM from Bob. Society B will then reflect the remaining \$1600 under Limits C and D.

The treatment of outstanding DEM costs when there is a venue operator change is shown below:



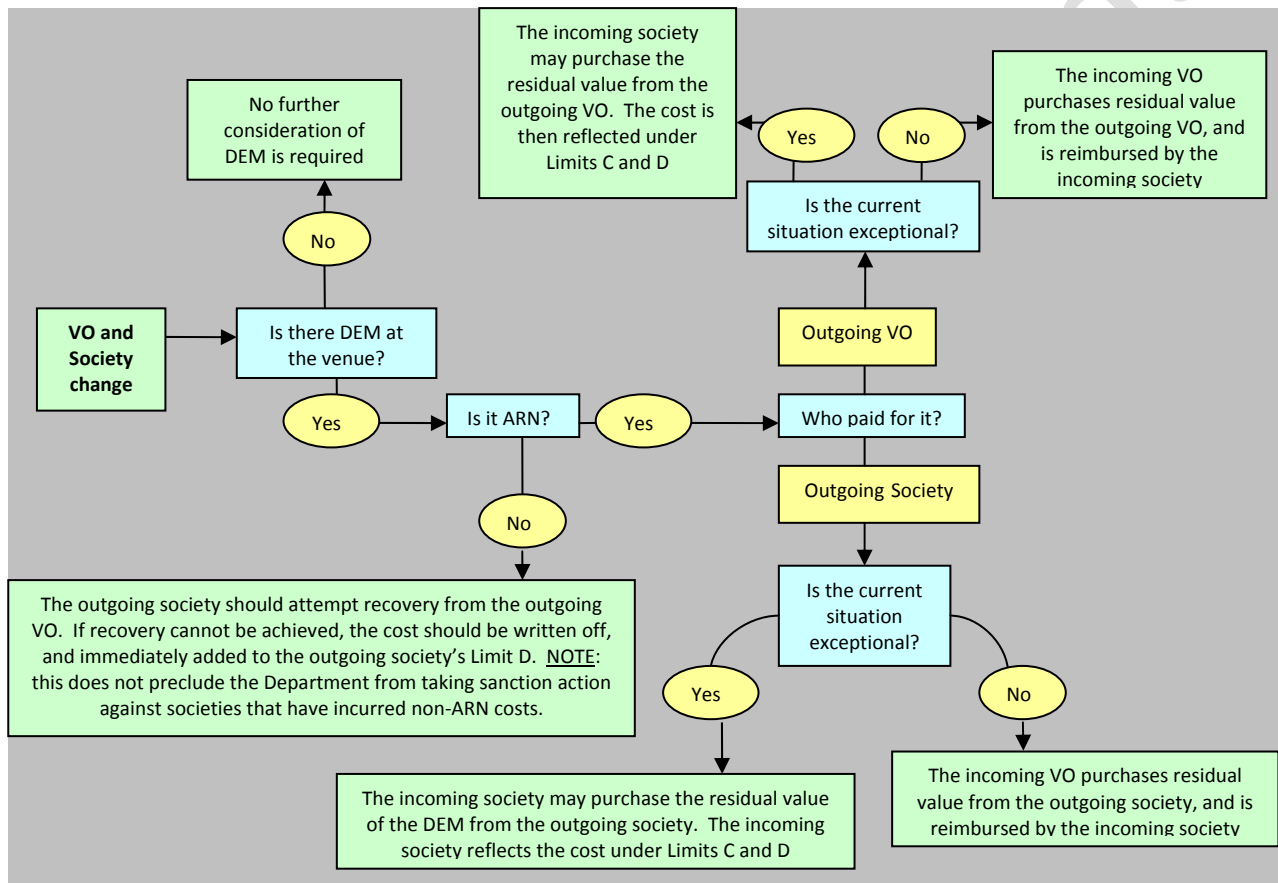
Scenario: Change of venue operator and change of society

Bob has decided to retire, so he sells his business to Joan. Joan wants to operate with Society C.

- If Society B has incurred the cost in the first instance, they work with Bob to recover residual \$1600 that has not yet been reflected under Limits C and D. They should then pass \$1600 on to either Joan or Society C as appropriate.

- In most cases, Bob will have incurred the cost in the first instance. Under this circumstance, Bob and Joan must negotiate payment for the residual \$1600 value. If Joan picks up the cost, Society C may agree to reimburse her if they agree that the cost is necessary.
- If Joan is unable to purchase the outstanding DEM, and Society C agrees that the cost is necessary, and they can make a convincing case for exceptional circumstances; then Society C may purchase the remainder of the DEM from Bob. Society C then reflects the \$1600 under Limits C and D.

The treatment of outstanding DEM costs when there is a venue operator and society change is shown below:



Appendix: FAQ's

What happens if a venue has existing DEM that has not been purchased in compliance with this policy?

Any DEM must continue to be reflected in the venue cost schedules, but the Society must consider how to limit risk of loss. This could include adding protective clauses to the venue agreement and/ or loan agreements. The Society may also choose to increase reflection/ reimbursement of the cost to speed up its' removal from the cost schedule.

What happens if a society is transferring all of its venues to a new entity?

Discuss this with the Department – in some cases outstanding DEM that has been purchased will be able to be transferred across to the new society (provided it is ARN).

What must a society do if a venue changes societies with DEM not fully reflected?

If the venue agreement includes protective provisions these must be enacted. If not, the society must attempt recovery from the venue operator, including means such as removal of items or legal action. If recovery fails or legal action becomes too costly, society can write off the debt, which then must immediately be added to the society's Limit D, contributing the their 16% Limit D payment cap.

What must a society do if they have purchased DEM but have not listed them in the venue cost schedule or added them to Limit D?

Any society that identifies that they have DEM that has not been reflected/ reimbursed appropriately under Limits C and D must contact the Department without delay.