



REVIEW OF GAMBLING ACT FEES 2007

Business Case

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1 Executive Summary

1. The costs of the Department of Internal Affairs (the Department) and the Gambling Commission in relation to the regulation of gambling are met by charging fees to the gambling industry. The Department is authorised under the Gambling Act 2003 (the Act) to recover these costs. A review of fees set under regulation usually occurs every three to five years. The latest review of fees has been undertaken and the proposed new fees have been calculated consistent with Audit and Treasury¹ guidelines.
2. Currently the costs of regulation are in excess of the revenue received, which is lower than forecast and the cost of effective regulation is greater than originally forecast. An adjustment to fees is required to recover these costs and to provide certainty of fee levels to the industry for the next 3 to 5 years.
3. When the fees were originally put into place Cabinet noted that "*due to uncertainty over how the gambling sector will respond to the new environment, and future volumes of work in a number of areas, DIA will monitor the business activity, costs and revenue in the first years of the fees coming into effect;*" [CAB Min (03) 41/4B refers].
4. The Cabinet paper also noted that "*... it was noted in the RIS/BCCS that accompanied the introduction of the Responsible Gambling Bill that reducing compliance costs is not a primary objective of the legislation*" [POL (03) 391 refers].

Lower Revenue

5. Lower than forecast revenue levels are the result of the numbers of gaming machines, operators and venues over the review period to 2012/13 stabilising at a number lower than was previously forecast.
6. The fall in gaming machines, operators and venues is due largely to the stricter licensing regime and reduced limits on machines allowed in venues introduced as part of the Act. It suggests that the Act's objective to control the growth of gambling is being met, but this reduces the base upon which costs can be recovered.

Higher Costs

7. The rise in forecast costs is due to a low-end estimation, in 2003 when the Act was passed and when the initial costs for electronic monitoring were set, of the capability required for a comprehensive approach to regulating the sector. The resulting fees were also set at a low-end estimated level. The actual costs of implementing the legislation effectively are now emerging from experience. Costs are being driven by the requirement of the Act to address broader outcomes and harder-to-measure activities, such as harm prevention and minimisation and dealing with crimes of dishonesty associated with gambling in both the casino and non-casino areas.
8. The Department is taking a strategic and longer-term perspective on how to achieve the specific purposes and broader outcomes of the Act. This is required by the Act, by commitments established in the Department's Statement of Intent (SOI) 2007-10 and is consistent with "best practice" regulatory approaches worldwide.

Historic Cost Drivers Too Narrow

9. An effect of the approach that is now necessary is that the number of machines, operators and venues is no longer as significant a cost driver for regulatory activity as it was. Increased depth and breadth of activity to meet the more stringent requirements

¹ The Treasury: *Guidelines for Setting Charges in the Public Sector*.

of the Act, together with increased infrastructure investment has meant the costs have become more fixed and less affected by changes (reductions) in volumes.

Costs Contained

10. The Department has contained a significant amount of the potential increase in expenditure. However it cannot reduce or defer all of the forecast cost pressures without seriously compromising the effectiveness of the gambling regulatory function and the ability to achieve the strategic outcomes sought. The proposed cost base going forward is the minimum required to meet the Department's responsibilities under the Act. Any reduction will lead to poorer regulatory outcomes (refer paragraph 67 - 84).

Fee Increase Still Proposed

11. The outcome of lower revenue and increased costs, even taking into account the significant cost containment to date, is that the costs of regulation currently charged to the gambling industry will result in an under recovery of \$17.488 million by 30 June 2013. The forecast deficit is not sustainable and represents the Crown, rather than the industry, funding this activity, which is contrary to the intent of the Act.
12. It is therefore necessary to review the fees and the related expenditure appropriation now. If there were no fee increase the reduction in forecast costs would mean a risk to the effectiveness of the gambling regulatory function and the ability to achieve the strategic outcomes sought.
13. Charging increased fees to the gambling sector will recover the increased costs from the industry and move the memorandum account into a credit position by the end of the fees review cycle in 2012/13.

2 Proposal

14. It is proposed to increase the fees set under the Act to a level that will recover the cost of gambling regulation over the medium term from the industry. It is proposed the new fees take effect from 1 January 2008.
15. The Department's costs to regulate the sector (including the costs of the new electronic monitoring system) increase by \$2.0 million in 2007/08 to between \$22 and \$23 million per annum. This represents less than 1.2% of the sector's revenue in the year to 30 June 2006 (which was approximately \$1.98 billion).

3 Background and Drivers

3.1 Background

16. The Act anticipates the costs of the Department and the Gambling Commission in relation to the regulation of gambling being met by charging fees to third parties². The Department operates a memorandum account to stabilise fees based on full cost recovery over the medium term (generally a four to five year planning horizon) consistent with the guidelines on setting charges in the public sector.
17. The review of fees set under regulation usually occurs every three to five years. Gambling fees (excluding EMS related fees) were last reviewed and set in conjunction with the passing of the Act and came into force on 1 July 2004. Cabinet noted that "*due to uncertainty over how the gambling sector will respond to the new environment, and*

² Section 370 of the Gambling Act 2003

future volumes of work in a number of areas, DIA will monitor the business activity, costs and revenue in the first years of the fees coming into effect;" [CAB Min (03) 41/4B refers].

18. The Cabinet paper also noted that *".. it was noted in the RIS/BCCS that accompanied the introduction of the Responsible Gambling Bill that reducing compliance costs is not a primary objective of the legislation"* [POL (03) 391 refers].
19. It is necessary to review the fees and the related expenditure appropriation now, as they are not recovering the cost of the proper, effective regulation of the sector. A review also provides an opportunity for the consolidation of all fees associated with the regulation of gambling into a single set of regulations.
20. The Act was a response to the growth of gambling in New Zealand and the resulting public concern. It introduced a more stringent licensing process and greater emphasis on compliance and enforcement for higher-risk gambling activities, together with an independent body, the Gambling Commission, to give gambling operators a formal right of appeal against licensing and compliance decisions made by the Department.
21. Since the Act was passed significant capability development has taken place to increase the Department's effectiveness in order to:
 - Take a very active approach to regulating the sector to ensure it meets the purposes of the Act;
 - Achieve the required outcomes of reducing gambling related harm and criminal activity; and
 - Ensure the proceeds of (non-casino) gambling benefit the community.

This has included the establishment of an appropriate technology base to support this activity (refer paragraph 38).
22. These developments took place in accordance with recognised "best practice" in regulatory practice worldwide.
23. Following the introduction of the Act the Department's appropriation to regulate the sector was approximately \$13.6 million. This represented less than 1% of the sector's revenue in the year to 30 June 2003 (which was almost \$2 billion). One of the key requirements of the Act was the introduction of an electronic monitoring system (EMS). The appropriation of \$13.6 million included, what in hindsight, were provisional and low-end estimates for the planned costs for the Department's implementation of EMS.
24. Subsequent to the passage of the Act, in 2003, a procurement process was undertaken to select a third party to undertake EMS. Information on the cost of monitoring derived from that pre-implementation process was used as the basis for the introduction of separate fees to cover the costs of electronic monitoring of non-casino gaming machines that were set in 2006. At that time the Department's costs for regulating the sector were estimated at approximately \$19.9 million.
25. During the EMS procurement process and the related fee setting it was not envisaged that the Department would have significant costs associated with monitoring except in the selection of the service provider, implementation to venues and setting up appropriate IT systems to collate and analyse information. This has proved not to be the case (refer paragraph 40).
26. The fees established when the Act was passed were set at a level that was, in hindsight, insufficient to regulate the sector comprehensively; the EMS fees were likewise set at a low-end level that did not take into account the final cost to the Department of implementing and running the system. The true costs of implementing

the legislation effectively are emerging from experience, as signalled in the Cabinet minute and extract referred to above.

3.2 Problem Definition

27. Currently the costs of regulation incurred by the Department are not being fully recovered from the industry. Effective regulation of the gambling sector will cost more, in future (a total of approximately \$22 million pa), than is currently recovered from the gambling sector (a total of approximately \$20 million pa). An adjustment to fees is proposed to recover these additional costs, address the current deficit and to provide certainty of fee levels to the industry for the next 3 - 5 years.
28. The current baseline does not allow the Department to fully meet the requirements of the Act and will therefore require an increased expenditure appropriation or a reduction in the level of regulation that is not consistent with full compliance with the Act.
29. Previous fee settings were based on a low-end estimate of the costs of regulating the sector effectively. The objective was to have recovered the costs of regulating the industry, from the industry, by 2009/10 [Refer Appendix A].
30. Current forecasts indicate reduced revenue levels over the next five-year period to 2012/13 and an increase in costs over that forecast in 2005, leading to a projected deficit of \$17.488 million by 30 June 2013 [Refer Appendix A].

4 Link to Business Objectives

31. Ensuring that gambling activities are fair and lawful, the growth of gambling has been controlled and harm has been prevented and minimised through effective regulation and enforcement contributes directly to the Department's outcome of *Safer communities*. This in turn contributes to the Government's priority "families – young and old", which incorporates sub-themes of "strong families" and "safer communities". Effective regulation of gambling also contributes strongly to the Department's outcome of Sustainable communities/Hapu/Iwi through ensuring that the proceeds of gambling are applied (as required by the Act) for the benefit of communities.
32. The Act came into force in 2003. However, most of its provisions did not come into force until 1 July 2004, and some had lengthy lead-in times. Early indicators point to a return on the investment made in respect of the Department's effectiveness in achieving the Act's objectives. For example, the reduction in the number of class 4 gaming machines and gambling expenditure suggest that the Act's objective to control the growth of gambling is being met.
33. The EMS system for the monitoring of non-casino gaming machines (a fundamental foundation for effective regulation) has now been successfully introduced by the Department as required by the Act and will enable the Department to more tightly monitor and control the use of non-casino gaming machines. EMS will also provide information about the amount of money gambled and to be banked, which provides a solid basis for ensuring that returns to the community are maximised, and improved information for policy and evaluation purposes. EMS should also reduce compliance costs for the sector in the future, particularly larger societies, through improved management information and reduced IT system requirements.
34. The Department's interventions focus on ensuring the gambling industry achieves a significant level of "voluntary compliance" because it understands the rules, recognises the risks of not complying, and sees the Department as a strong and effective regulator, willing and able to take appropriate enforcement action where necessary.

Increased voluntary compliance contributes directly to achievement of the outcomes and, over time, should reduce the cost pressures associated with regulatory activities.

5 Link to Business Strategy

35. Since the Act was passed the Department has undertaken significant capability development to increase its effectiveness to achieve technical compliance with the specific regulatory provisions of the Act. The rollout of EMS signalled the completion of the implementation of the Act that has taken place over the last 4 years. However the Act also requires, and the Department is required through its SOI, to undertake, regulatory activity on broader and less easy to measure activities, such as harm prevention, problem gambling and crimes of dishonesty associated with gambling.
36. The Department is taking a strategic and longer-term perspective on achieving the specific purposes and broader outcomes of the Act consistent with the intentions articulated in the Department's SOI 2007-10.
37. In 2006/07 the Department conducted a major review of its compliance approach and how a range of stakeholders perceive the Department as it undertakes its compliance activities. This was followed by the recent performance audit by the Office of the Auditor-General (OAG) (*Effectiveness of Controls on Non-casino Gaming Machines*), which confirmed that, while the fundamental elements of compliance were in place, the Department's strategic approach to compliance is still emerging in key areas, such as outcome and performance measurement and its approach to risk profiling and the conduct of audits.
38. The following are the key elements of the strategy over the next 5 years:
 - A strong emphasis on encouraging voluntary compliance as the basis for achieving outcomes and containing the cost of regulation. This will be achieved by more effort and resource being committed to engaging, listening and communicating with stakeholders at both the national and regional levels;
 - The ongoing building of intelligence and investigations capability. This assists the Department in developing a better understanding of the broad impact of gambling on society and in responding to and investigating more sophisticated approaches to criminal activity occurring in the casino and non-casino environments, both nationally and internationally. To combat these trends demands strong audit and investigative responses and intelligence capability;
 - Greater use of technology to enhance the cost effectiveness of compliance activities, with EMS as the central platform to achieve this. The Department is exploring the feasibility of developing an integrated technology platform, with the EMS network as its base, with the objective of improving the efficiency and effectiveness of gambling compliance activities and reducing costs for the gambling sector;
 - Building capability to support the increasing technical demands of EMS and technical sophistication of gaming machines and to build international linkages that are becoming increasingly important as a result of the standardisation of technical requirements across jurisdictions;
 - Achieving more consistency as well as flexibility in compliance activities by rationalising and standardising compliance systems, practices and supporting structures across the regulatory function, reviewing the risk profiling and audit approaches and putting renewed emphasis on measuring compliance outcomes as recommended in the OAG report. This will also include taking

advantage of the strengthening of the governance, IT and project management capability that has occurred within the wider Department over the last 3 years.

6 Costs

39. The forecasted expenditure has been driven by the following factors, which are a mix of increases associated with fully implementing the Act and those associated with addressing the Act's broader, strategic requirements.

6.1 Implementing the Act

EMS:

40. The system development costs, the business impact of integrating EMS into existing systems and processes and the level of the Department's ongoing management and support of EMS are key drivers. Pre installation these were all difficult to forecast and in hindsight a very low-end estimate was used at the time EMS budgets were developed and the fees set in 2006 [additional \$4.099 million over period of review – refer table 2].

Salary Costs

41. Forecast costs allow for salary increments of 2.5% per annum until 2009/10. This treatment is consistent with the ongoing funding of the Department's Crown funded areas³. Previously the fees model did not allow for rising costs due to salary increments. No other inflationary costs are currently built into the model [additional \$2.836 million over period of review – refer table 2].

Gambling Commission:

42. The Commission has asked for an increase in their budget of \$0.200 million per annum (effective from 1/7/07) to cover costs associated with the increased and unforeseen complexity of the cases being heard and associated, additional legal expenses [additional \$1.200 million over period of review – refer table 2].

6.2 Achieving the Act's Broader Objectives

Intelligence & Investigations

43. The Intelligence and Investigations Units are new or increased activities for the Department, not fully costed into the existing fees model. The Units support the compliance function by providing a range of intelligence products and services, which identify and assess the nature and risk of trends, groups and individuals impacting upon the regulatory environment. They provide tactical, operational and strategic intelligence in support of the Act's compliance objectives and manage and store information in a secure environment. The Units maintain relationships with external groups to enhance the Branch's role as a regulator and support an overall government approach to law enforcement. This includes the Department's contribution to the international effort to combat money laundering.
44. The Intelligence unit was established in 2003 and has developed, in line with the business strategy, in recognition of the important role of intelligence in increasing the effectiveness of regulation and compliance activity [additional \$1.532 million over period of review – refer table 2].

³ The Department has been funded for salary growth in Crown funded areas through to 2008/09.

45. The Investigations unit was established in 2004 and has developed to address the more sophisticated approaches to criminal activity, both nationally and internationally, which impact on the gambling sector [additional \$0.303 million over period of review – refer table 2].

Technical Gaming & IT

46. As part of its regulatory function, the Department tests, approves and certifies games, gaming machines and other gambling equipment and sets and monitors technical standards for their operation. Given the Act's control on gaming machine numbers, both within casinos and outside, operators have put a greater emphasis on technological change as a way of maximising revenue.

47. Capability has been increased in these areas to reflect the increasing technical demands of EMS, the technical sophistication of gaming machines and the ongoing improvements in IT systems, especially the Department's key licensing and compliance system that was developed and implemented in 2004/05 [additional \$0.843 million over period of review – refer table 2].

Casino Compliance:

48. Over the last two years the regional Casino Inspectorates have moved off-site from the casinos in Auckland, Hamilton, Dunedin and Christchurch. An offsite move for the Queenstown Inspectorate is necessary and has been costed into this Fees review. The objective is to enhance the ability of the Inspectorate to carry out their functions by ensuring sufficient independence, both perceived and real, existed when dealing with other agencies and members of the public. This has led to additional rental costs and depreciation for capital expenditure on casino surveillance equipment [additional \$1.002 million over period of review – refer table 2].

Departmental capability

49. The strengthening of the wider Department's governance, IT and project management capabilities from which the gambling regulatory function receives considerable benefit (additional \$6.840 million over period of review – refer table 2).

6.3 Managing Cost Pressures to Date

50. The Department has to date contained the following costs pressures within baselines since fees were last adjusted in 2003/04. These are:

- General savings in the 3rd party funded areas are forecast in 2006/07 as a result of rigorous budget management [\$0.500 million].
- The increase in staffing and activity relating to the Intelligence and Investigation Units [\$1.250 million to date].
- Salary increases [\$1.200 million to date].

51. In summary, as a short-term response the Department has contained within baselines costs of \$2.950 million to date, in addition to other general inflationary increases since the last fees review in 2003/04. The total cost of regulating the sector effectively that is now emerging means it is no longer possible to contain future costs within existing baselines without seriously compromising the effectiveness of the gambling regulatory operation and the achievement of strategic outcomes sought [refer paragraphs 67 - 84].

52. These savings have been factored into the forecast deficit projections [refer Appendix A].

6.4 Managing Cost Pressures Going Forward

53. The Department is currently reviewing the cost/effectiveness of the gambling compliance operation over the medium to long term by addressing the appropriate profile of costs against the backdrop of the reduced number of gaming machines, operators and venues, the use of EMS as a platform for driving further cost efficiencies and benefits to the sector, and the overall strategy of maximising voluntary compliance underpinned by effective deterrence.
54. The objective is to reach a consistent cost base that will provide certainty of fee levels to the industry for the next 3 - 5 years.
55. In 2006/07 the Department conducted a major review of its compliance strategies and how a range of stakeholders perceive the Department as it undertakes its activities. The results of this analysis have now been fed into a current review of organisational structure. The aim of the review is to ensure compliance activity is being undertaken in the most cost effective and efficient manner, consistent with strategies and objectives. Anticipated cost savings of \$2.925 million over the period of review have been factored into the calculation of forecast costs (refer table 2).
56. Savings relating to assumptions made when fees were last set in 2004 in respect of out year depreciation and operational costs have also been factored into the forecast costs [\$1.258 million and \$1.350 million respectively – refer table 2].
57. Salary increments have been provided for at 2.5% per annum from 2007/08 through to 2009/10. It is intended to meet salary increment from 2010/11 onwards from within the new proposed baselines. Assuming salary increases continuing at the rate of 2.5% per annum this amounts to \$1.196 million over the balance of the period of review⁴. Assuming other inflation increments to be 3% per annum this would amount, in total, to \$2.140 million in additional costs being contained within proposed baselines.
58. The Department has already identified and commenced action on a number of the issues raised in the OAG report. These include:
- Further developing outcome measures relating to compliance levels for the next SOI and clearly linking these to compliance activity;
 - Reviewing licensing checks and addressing other licensing issues raised, while continuing to take a risk-based approach and balancing the requirement for checking against compliance costs;
 - Reviewing the audit risk profile, the risk assessment process, and other policy and process documentation associated with audits.
59. Costs are emerging associated with implementing the recommendations of the OAG report and more effort and resource being committed to engaging, listening and communicating with stakeholders at both the national and regional levels as signalled in the 2006/07 review of the Department's compliance approach. These costs have not been factored into the proposed fees as they cannot yet be quantified.
60. The Department is exploring the feasibility of developing an integrated technology platform, with the EMS network as its base, with the objective of improving the

⁴ The Department has been funded for salary growth in Crown funded areas to 2008/09.

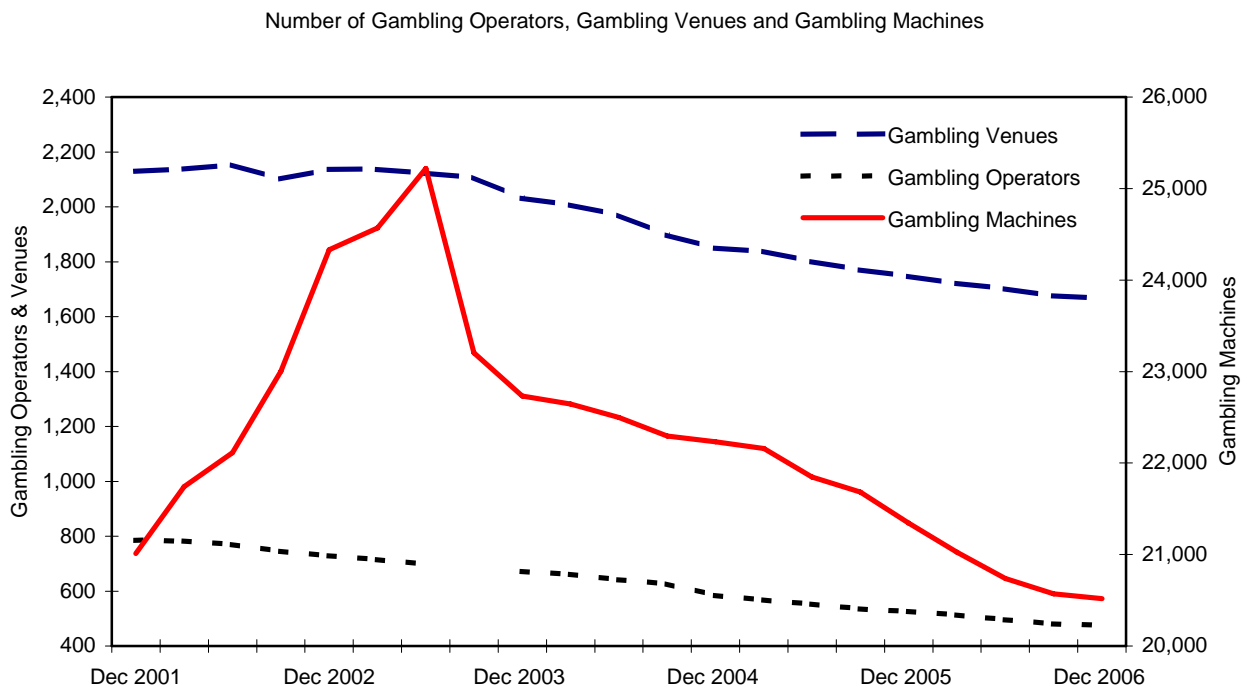
efficiency and effectiveness of gambling compliance activities and reducing overall costs for the gambling sector.

61. No costs or benefits have been factored into the fees model as this concept is only at the feasibility stage. However as a result of this project a decision has been taken not to budget for the complete replacement of the Department's licence and compliance system, with an estimated saving of \$3 million in depreciation charges over the period of the review. Amounts sufficient to maintain the current system to the required standard have been included in out years.

62. In summary, it is intended to save or contain, in the medium to long term, costs of \$11.869 million over the period to 2012/13, offset by extra costs arising from the OAG review, which are yet to be quantified. These have been factored into the forecast deficit projections [refer Appendix A].

7 Volumes and Revenue Changes

63. The Act introduced a much stricter licensing regime and reduced limits on machines allowed in venues. At 30 March 2007 the number of gaming machines has declined by 19.5% from 30 June 2003. The numbers of licence holders and venues that operate gaming machines have also declined significantly since 2003, by 36% and 24% respectively. The decline in operators, venues and machines is shown graphically below.



64. These declines have been progressively reflected in the volume forecasts prepared by the Department since 2003 as shown in Table 1 below.

Table 1: Current and prior forecasts of machine numbers, venues and operators

Prior/Current Forecasts	2003	2005	2007 onwards (projected)	% Decline since 2005
Machines	21,778	21,000	20,000	5
Venues	1,877	1,850	1,580	15
Operators	528	528	440	17

65. The forecasts for 2007 provide the basis for the current revenue calculations. The impact on revenue is factored into Table 2. The numbers of machines, operators and venues is forecast to stabilise at the lower 2007 level. This will significantly impact on revenue in the next five years and has shrunk the base upon which costs can be recovered.

8 Financial Implications

66. Table 2 below itemises the changes in revenue and expenditure forecasts from the last Appropriation increase in 2005.

Table 2: Changes in Revenue and Expenditure Forecasts

2005-2007 Reconciliation	2007/08 \$000	2008/09 \$000	2009/10 \$000	2010/11 \$000	2011/12 \$000	2012/13 \$000	Total Impacts \$000
Revenue							
Forecast							
Baseline 2005	21,166	21,166	21,166	21,166	21,166	21,166	
Reduced Class 4 Revenue	(524)	(524)	(524)	(524)	(524)	(524)	(3,144)
Reduced EMS Revenue	(350)	(350)	(350)	(350)	(350)	(350)	(2,100)
2007 Forecast	20,292	20,292	20,292	20,292	20,292	20,292	
Expenditure							
Forecast							
Baseline 2005	19,931	20,021	20,021	20,021	20,021	20,021	
EMS	1,062	922	776	549	395	395	4,099
IT & Technical Gaming	225	146	113	113	123	123	843
Casino Offsite moves	167	167	167	167	167	167	1,002
Gambling Commission	200	200	200	200	200	200	1,200
Salary Increases	185	375	569	569	569	569	2,836
Organisational Review	250	(635)	(635)	(635)	(635)	(635)	(2,925)
Intelligence	252	256	256	256	256	256	1,532
Investigations	49	50	51	51	51	51	303
Departmental Capability	1,110	1,146	1,146	1,146	1,146	1,146	6,840
Depreciation	-	-	(175)	(185)	(376)	(522)	(1,258)
Operational Efficiencies	(225)	(225)	(225)	(225)	(225)	(225)	(1,350)
2007 Forecast	23,206	22,423	22,264	22,027	21,692	21,546	

9 The Options

67. There are three single or combined courses of action available:

- Do nothing

- Reduce costs further
- Raise fees

9.1 Do Nothing

68. The option of doing nothing is a risk as an increase in fees is necessary to recover the additional costs required to regulate the gambling sector effectively and maintain the Department's ability to achieve the strategic outcomes sought. Any reduction in the proposed cost base will lead to a reduction in regulation that is not consistent with full compliance with the Act.
69. The forecast deficit is not sustainable and represents the Crown rather than the industry funding this activity. With no fee increase the forecast costs would have to be funded by the Crown, which would mean the taxpayer funding a portion of the cost of gambling regulation, which is contrary to the intent of the Act.

9.2 Reduce Costs Further

70. The Department could elect to focus primarily on a "cost savings" approach, for example reducing the number of staff employed in regulation even further than currently proposed [refer paragraph 84], at the expense of taking a more strategic view and continuing to focus on achieving the purposes of the Act. This would be at variance with what the OAG report recommended and, in a wider context, with the Department's mandate under the Act and will lead to poorer regulatory outcomes (refer paragraphs 68 to 84).
71. The current and forecast capability is required to achieve the specific purposes and broader activities of the Act. This will include the encouragement of voluntary compliance through engagement with a wide range of stakeholders at all levels, which is a resource intensive activity, and intelligence and investigations activity to support the focus on higher risk areas of the gambling sector. Cost cutting will undermine this activity.

9.2.1 Reducing by Cost Driver

72. Taking each major activity area the impact and/or feasibility of reducing costs further is as follows:

Casino Compliance

73. With the passing of the Act the Department assumed responsibility for activities that were previously carried out by the Casino Control Authority (CCA). In estimating the costs of these activities it was necessary to rely on information from the CCA. The practical effect of the changes in requirements for some of these functions was at that stage largely unknown. As a result the costs of the Casino regulatory functions were underestimated at the time the fees were set in 2004.
74. The high level of public, commercial, government and media interest around casinos leads to high stakeholder expectations that the Department will be a sophisticated and competent regulator. Due to casino operators' international links the Department needs to continually enhance its understanding of the requirements of effective casino regulation in an international context. The Department works closely with other government agencies, Australasian and other international jurisdictions, to enhance its enforcement, intelligence, and policy tools and learn from the example of others. The planned level of investment in policy, intelligence, investigations and stakeholder management is critical to achieving the regulatory outcomes sought.

75. Refer Appendix D for a more detailed analysis of the impact of the Act on the regulation of casinos.

Non-Casino Compliance

76. Although traditional drivers of activity such as the number of machines, venues and operators have declined, those are no longer key cost drivers. The effort required in meeting the more stringent requirements (licensing in particular) of the Act has proved greater than anticipated at the time the Act was introduced in 2003. Therefore the forecast lower level of machines, venues and operators has a minimal impact on costs, but a significant negative impact on the revenue derived to fund compliance activity.

77. The audit process is now more complex and although fewer audits are being performed since the Act was introduced, the depth and breath has increased. For example, the focus is increasingly on governance and accountability of societies, together with an in depth analysis by qualified accountants of financial viability as required by the Act. It is not possible to reduce costs further and retain an effective audit and compliance process.

78. Refer Appendix E for a more detailed analysis of the impact of the Act on the regulation of the non-casino sector.

Intelligence & Investigations

79. There is a clear expectation in the purposes of the Act that opportunities for crime will be limited. Organised crime, fraud, theft to meet debts, and other crimes are all potentially linked with gambling. The investment to date by the Department in investigations and intelligence capability is required to combat crime associated with gambling and to ensure that gambling operators are taking appropriate steps to prevent crime.

80. The Department has been involved in a number of major investigations, examples of which are provided in Appendix F.

Technical Gaming & IT

81. The introduction of EMS coupled with the modernisation of the Department's IT infrastructure has resulted in a platform that facilitates the use of modern technology in undertaking regulatory activity. It is critical that this platform is adequately supported and that the Department is able to respond effectively to ongoing technology changes in the gambling sector. These investment decisions and ongoing maintenance represent a fixed cost that is difficult to reduce.

Gambling Commission

82. The Commission and its activities are mandated by the Act. A high level of Commission activity also means increased activity on the part of the Department in responding to such things as appeals and casino licence conditions.

9.2.2 Changes in FTE's

83. Table 3 below shows the changes in total staffing levels since the last full review of fees in 2003/04 and the projected levels incorporated into the proposed new fees.

Table 3: Movement in FTE's

Movement	FTE's
Total in 2003/04	104
Intelligence	4
Investigations	1
EMS/Technical gaming	6
Management/ Support	2
Current	117
Organisational Review	(6)
Total Projected from 2007/08 onwards	111

84. The Department is still operating at the same number of core audit and compliance staff envisaged at the time the Act was introduced. Subsequent additions to staff since 2003 have been as a result of EMS, which is a mandated requirement under the Act, and the Department's regulatory strategy and approach to achieving the broader outcomes of the Act as outlined in Section 5. The forecast reduction in staff from 2007 onwards is the result of the organisational review [refer paragraph 55] to ensure regulatory activities are undertaken in the most cost effective and efficient manner, consistent with our strategies and objectives.

9.3 Preferred Option

85. The Department is unable to reduce or defer all of the forecast costs (and thereby eliminate the need for fee increases) without seriously compromising the effectiveness of the gambling regulatory operation and the ability to achieve the outcomes required under the Act.

86. Current and projected staffing is considered the minimum number required to meet the requirements of the Act. Any further reduction in staff would reduce the Department's ability to achieve its strategic outcomes and lead to poorer regulatory outcomes (refer paragraphs 67 to 84).

87. An increase in fees is the recommended option.

10 Fees

88. If expenditure and revenue remain as forecast, fees will need to rise to ensure appropriate cost recovery to bring the memorandum account back into balance by 2012/13 as shown in Table 4 below.

Table 4: Forecast Fee Increases

Fee	Current Revenue 2007/08 & Outyears \$000 per annum	Forecast Revenue 2007& Outyears \$000 per annum	Revenue Increase
Non-Casino Operators/venues	9,165	9,943	8.5%
Casinos	4,109	5,242	27.6%
Electronic Monitoring	7,018	8,287	18.1%
TOTAL	20,292	23,472	15.7%

89. Table 5 below puts those increases into context by looking at the impact of rises in non-casino fees on clubs and medium and large societies and the impact of the casino fees on the individual casinos. As further context for the casino increases gaming revenue in 2006 for the 6 casinos amounted to \$493 million (up from \$472 million in 2005). Of this Sky City Auckland accounted for \$334.8 million and Sky City Hamilton \$29.8 million, (increases of 5% and 9.1 % respectively on 2005). The proposed detailed fee schedule is attached as Appendix C.

Table 5: Impact of Proposed New Fees

Impacts of Proposed Fees			
Non Casino Gaming - Annual Licensing & Compliance Fees (incl EMS)	Estimated annual Gaming machine profits	Proposed New Fee (GST incl)	Fee Increase
Scenario 1 Club with 10 gaming machines	\$180,000	\$10,329	15.5%
Scenario 2 Society with 5 venues, 70 machines	\$3,950,000	\$70,079	15.2%
Scenario 3 Society with 50 venues, 900 machines	\$53,010,000	\$819,957	13.9%
Casinos - Annual Operator Fees		Proposed New Fee (GST incl)	Fee Increase
Sky City Auckland		\$2,894,926	30.5%
Sky City Hamilton		\$733,512	33.8%
Christchurch		\$1,253,045	35.4%
Dunedin		\$556,894	16.7%
Sky City Queenstown		\$237,823	0.1%
Queenstown Wharf		\$221,434	2.4%

90. The sharp rise in the annual casino operators' fee is driven by the following factors:

- The annual fee charged to each casino is a combination of the Department's and Gambling Commission's direct costs, plus allocated support costs and overheads on the basis of player positions at table games and gaming machines. The costs of the casino regulatory functions were underestimated at the time the fees were set in 2004. Since then the Department's overhead costs have increased and the Gambling Commission's activity in relation to casinos has increased in excess of the original forecasts;

- Over the last two years the regional Casino Inspectorates have moved off-site from the casinos in Auckland, Hamilton, Dunedin and Christchurch. In addition an offsite move for the Queenstown Inspectorate is necessary and has been costed into this Fees review. The objective was to enhance the ability of the Inspectorate to carry out their functions by ensuring sufficient independence, both perceived and real, existed when dealing with other agencies and members of the public. This has led to additional rental costs and depreciation for capital expenditure on casino surveillance equipment of \$1.002 million over period of review.
- The allocation between casino and non-casino functions of the costs of business support such as intelligence, investigations and operational policy, have changed since fees were last reviewed in 2003/04. This reflects the change in the focus of activity in casino compliance from routine audit work to specific investigations in key risk areas such as problem gambling and criminality in casinos. The result has been a more accurate allocation of costs between casino and non-casino functions.

11 Financial Impacts

88. The impact of the proposed fee increases on the recovery of costs from the industry and on the memorandum account is to eliminate the deficit by 2012/13 as shown in Table 6 below. The assumption is that the new fees apply from 1 January 2008.

Table 6: Forecast memorandum account with proposed fee increases

Forecast (Excl GST)	2006/07 \$000	2007/08 \$000	2008/09 \$000	2009/10 \$000	2010/11 \$000	2011/12 \$000	2012/13 \$000
Revenue (Increased Fees)	18,156	21,882	23,472	23,472	23,472	23,472	23,472
Expenditure	19,300	23,206	22,423	22,264	22,027	21,692	21,546
Surplus/(Deficit)	(1,144)	(1,323)	1,049	1,209	1,445	1,780	1,926
MOA Opening	(4,938)	(6,082)	(7,405)	(6,356)	(5,147)	(3,702)	(1,922)
MOA Closing	(6,082)	(7,405)	(6,356)	(5,147)	(3,702)	(1,922)	4

91. An appropriation increase will be required. Table 7 shows the change required to existing baselines.

Table 7: Required Change to Appropriations

Internal Affairs - Gaming Regulatory Services	2007/08 \$000	2008/09 \$000	2009/10 \$000	2010/11 \$000	2011/12 \$000	2012/13 \$000
Appropriation						
Current Appropriation Gaming ⁵	21,061	21,187	21,187	21,187	21,187	21,187
New Appropriation Sought	23,206	22,423	22,264	22,027	21,692	21,546
Increase Required	2,145	1,236	1,077	840	505	359

⁵ Total Appropriation for the output class includes additional amounts relating to Censorship and Anti-Spam compliance activities

92. The Department's costs to regulate the sector increase to a maximum of \$23.206 million in 2007/08 before reducing to \$21.546 million in 2012/13. This represents less than 1.2% of the sector's revenue in the year to 30 June 2006 (which was almost \$1.98 billion).

12 Risks

93. The following are the key risks underpinning the calculation and introduction of new fees. The risks with respect to the implementation process of adjusting fees are considered in Section 14 below.

- That machine numbers, license holders and venues will be lower than forecast, further reducing revenue and the base upon which costs can be recovered. As noted, given the increasingly fixed nature of costs a reduction in numbers no longer reduces costs.
- That daily EMS fees collected from the sector are less than forecast. The contract with Intralot provides for a payment based upon 21,800 machines "connected", whereas the daily EMS fees are charged to the sector on machines with operated activity in any particular day. An assumption of 95% daily activity is built into the fees model, which will require time to validate. Experience to date reaffirms the current assumption.
- That levels of activity and cost going forward are greater than forecast. The Department's experience with administering the Act means costs can now be estimated with reasonable certainty. Those drivers that are known or can be foreseen with reasonable certainty have been included. The Department has taken a constrained approach to assessing forecast expenditure and has not included any general contingency for unforeseen events.
- That changes recommended by the OAG cannot be accommodated within the forecast baseline. The additional costs associated with implementing the recommendations of the OAG report are still emerging and cannot yet be fully quantified.
- That the ongoing modernisation of the R&C technology platform can be accomplished out of efficiency savings and will not require a significant capital injection. No costs or benefits have been factored into the fees model as the project is only at the feasibility stage.
- That an inability to obtain an appropriation or fee increase or if new fees are implemented after 1 January 2008 will negatively impact on the Department's ability to regulate the sector effectively and increase the deficit. Delays in obtaining an increase in fees equates to potential lost revenue (and corresponding increase in the deficit memorandum account balance) of \$265,000 for each month of delay. The Department is managing and will continue to manage to the current, approved baseline.
- That the anticipated cost savings of \$2.925 million per annum from the Department's review of its organisational structure are not able to be realised. Final decisions arising from the review are not yet made and are subject to an internal change and consultation process.

13 Implementation of Recommended Solution

13.1 Implementation Timetable

94. The recalculation and adjustment to fees is being managed as a project in accordance with the Department's project management methodology. The timescales and major project milestones are noted in Table 8 below:

Table 8: Milestones and Deadlines

Milestone	Timescale
Proposal submitted to EMT for review	15 May 2007
Proposal submitted to Minister for comment	15 June 2007
Paper submitted to Cabinet Office for EXG on 8 August	2 August 2007
Cabinet approves proposal for consultation	13 August 2007
Public consultations end	13 September 2007
Paper submitted to Cabinet Office for EXG on 17 October	11 October 2007
Cabinet approves change to fees	29 October 2007
Regulations drafted by Parliamentary Council	22 November 2007
Regulations approved by LEG	22 November 2007
Regulations enacted by the Governor General	26 November 2007
New fees gazetted	29 November 2007
New fees come into effect	1 January 2008

13.2 Project Structure

95. The major project roles with associated responsibilities are noted in Table 9 below.

Table 9: Project Roles

Project Role/ Member	Name	Business Unit
Sponsor	Keith Manch	Regulation & Compliance
Steering Committee	John Markland	Regulation & Compliance
Steering Committee	Mike Hill	Regulation & Compliance
Steering Committee	Peter Burke	Regulation & Compliance
Steering Committee	Brett Percival	Business Services Branch
Project Team	Peter Holbert	Regulation & Compliance
Project Team	Dean Wightman	Regulation & Compliance
Project Team	Lloyd Bezett	Regulation & Compliance

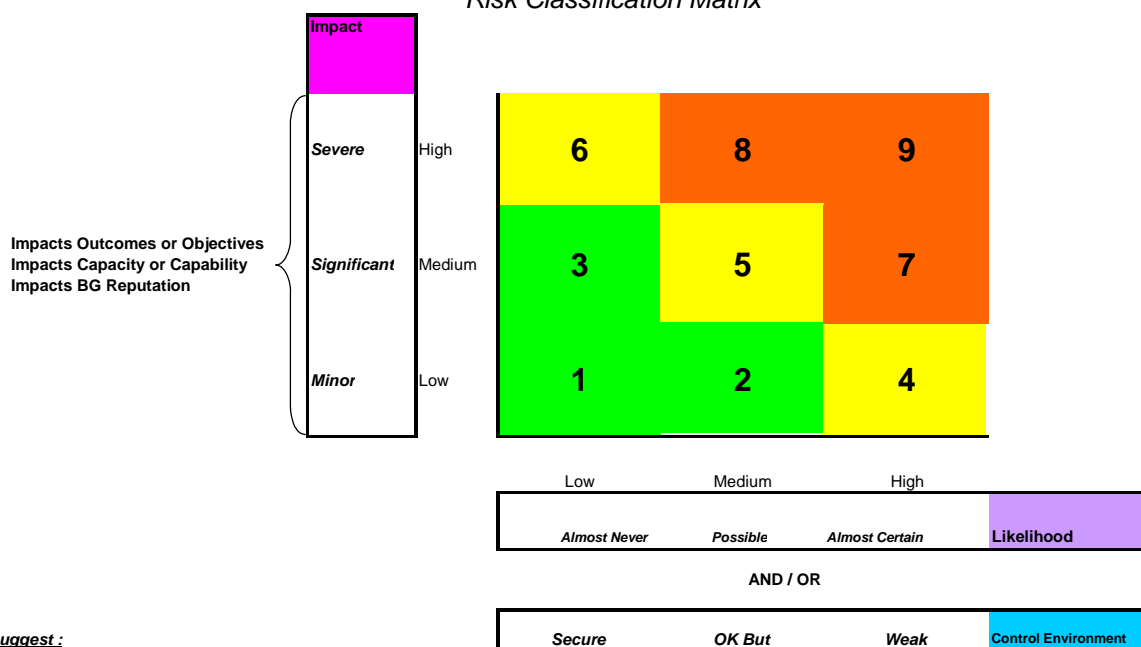
14 Risk Assessment

96. The potential risks associated with the project are outlined in Table 10 below. Each risk has been evaluated for likelihood and consequence (impact) and weighted using the Project Delivery Toolkit Risk classification matrix shown below.

Table 10: Results of Risk Assessment

No.	Description	Likelihood	Impact	Score	Proposed Mitigation
1.	Delay in process leads to Department's fiscal position being at risk	Medium	Medium	5	Set up as a project with tight project management
2.	Costs and fees misstated due to incorrect volumes/activities estimates for activities	Low	High	6	Independent assessment of the numbers and the model at key stages of the process.
3.	Project Resources unavailable at key points	Medium	High	8	Project approach – key resources scheduled ahead of time
4.	Criticism of the department by sector and Ministers as a result of fees proposed	High	Medium	7	Build strong business case, include strategic context. Good communication strategies.
5.	Delays in process because the proposal is considered to have significant economic impact and likelihood of controversy	Medium/ High	Medium		Build strong business case, include strategic context. Good communication strategies. Set up as a project with tight project management

Risk Classification Matrix



Suggest:

All Risks being reported to Business/Project Manager
 Score of 5+ Risks reported to General Manager
 Score of 7-9 Risks communicated to Chief Executive

15 Consultation

97. This Business Case has been prepared for internal discussion and approval from within the Department and to facilitate discussions with other government agencies, especially the Treasury. Cabinet approval will be sought to consult the public and stakeholders on the proposed fees⁶.

⁶ Refer section 372 of the Gambling Act 2003

Appendix A – Memorandum Account Forecasts

Memorandum Account Forecast 2005 (at the time EMS budgets were developed)

Table 11: Memorandum Account Forecast: April 2005

Forecast (Excl GST)	2005/06 \$000	2006/07 \$000	2007/08 \$000	2008/09 \$000	2009/10 \$000	2010/11 \$000	2011/12 \$000
Revenue (Current Fees)	14,093	18,496	21,166	21,166	21,166	21,166	21,166
Expenditure	15,203	19,330	19,931	20,021	20,021	20,021	20,021
Surplus/(Deficit)	(1,110)	(834)	1,235	1,144	1,144	1,144	1,144
MOA Opening	(1,525)	(2,635)	(3,469)	(2,234)	(1,090)	55	1,199
MOA Closing	(2,635)	(3,469)	(2,234)	(1,090)	55	1,199	2,343

Memorandum Account Forecast 2007 (without a fee increase)

Table 12: Memorandum Account Forecast: April 2007

Forecast (Excl GST)	2006/07 \$000	2007/08 \$000	2008/09 \$000	2009/10 \$000	2010/11 \$000	2011/12 \$000	2012/13 \$000
Revenue (Current Fees)	18,156	20,292	20,292	20,292	20,292	20,292	20,292
Expenditure	19,300	23,206	22,423	22,264	22,027	21,692	21,546
Surplus/(Deficit)	(1,143)	(2,914)	(2,131)	(1,972)	(1,735)	(1,400)	(1,254)
MOA Opening	(4,938)	(6,081)	(8,995)	(11,126)	(13,098)	(14,833)	(16,233)
MOA Closing	(6,081)	(8,995)	(11,126)	(13,098)	(14,833)	(16,233)	(17,488)

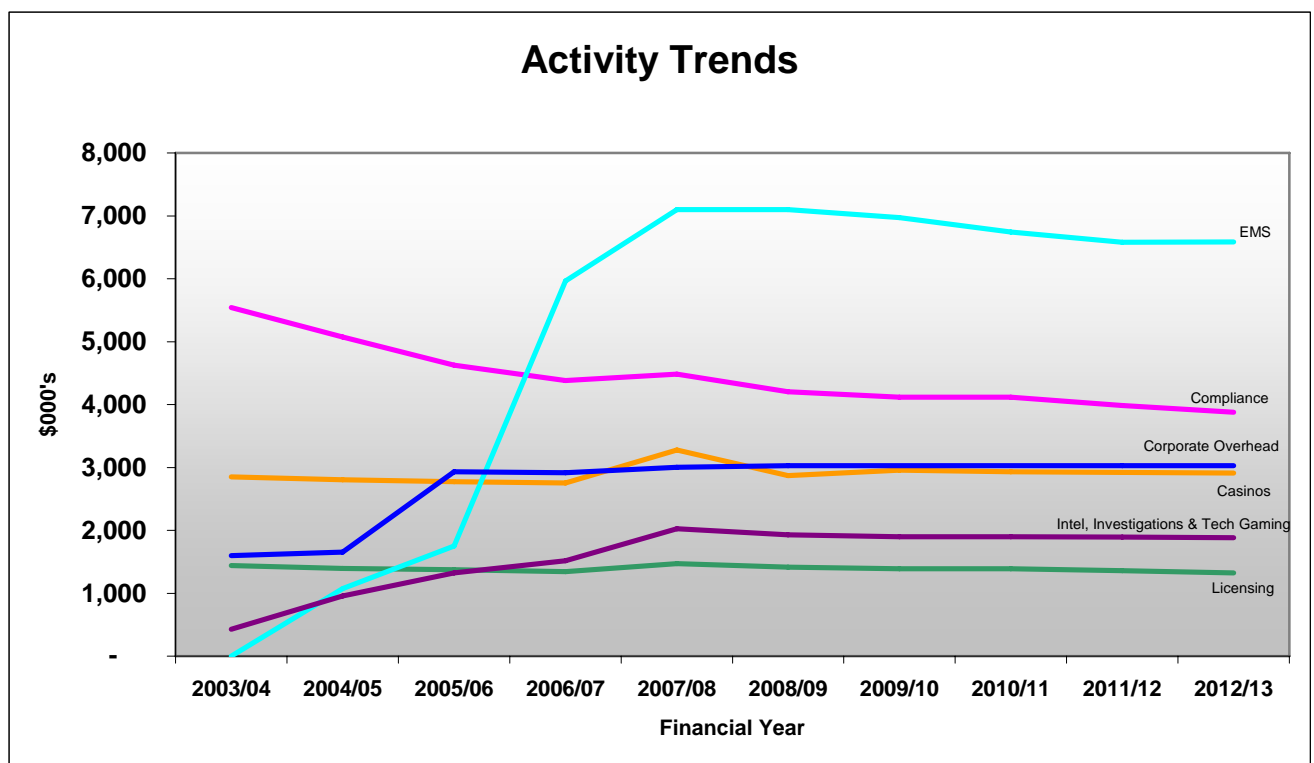
Notes

1. The closing balance in the memorandum account (MOA) at 30 June 2006 was a deficit of \$4.938 million and included a one-off adjustment of \$2.3 million for accounting treatment of fees. The adjustment reflects accounting policy to correct the recognition of non-casino gaming machine revenue. The policy recognises the revenue received in advance for gaming machine licenses and this treatment complies with current international accounting standards. When the one-off adjustment is excluded, the MOA is similar that forecast in 2005, when the EMS budgets were developed.
2. The sharp rise in costs from 2006/07 to 2007/08 largely reflects the full impact of EMS in the first full year of operation, and also the impacts of increased capability both of the Branch and of the Department.

Appendix B – Costs by Activity (both fixed and variable)

Table 13: Analysis of Costs by Activity

Activity	2003/04 \$000	2004/05 \$000	2005/06 \$000	2006/07 \$000	2007/08 \$000	2008/09 \$000	2009/10 \$000	2010/11 \$000	2011/12 \$000	2012/13 \$000
Licensing	1,438	1,392	1,376	1,342	1,471	1,415	1,390	1,390	1,358	1,322
Compliance	5,542	5,074	4,625	4,380	4,481	4,205	4,116	4,116	3,985	3,880
Casino Compliance	2,851	2,804	2,772	2,754	3,275	2,871	2,957	2,933	2,920	2,911
EMS	-	1,072	1,751	5,962	7,101	7,097	6,971	6,743	6,582	6,583
Operational Policy	866	866	866	866	784	801	817	817	817	817
Gambling Commission	869	869	869	869	1,065	1,074	1,083	1,099	1,109	1,119
Intelligence	110	220	584	548	658	683	687	686	678	671
Investigations	-	415	418	403	479	484	499	499	499	499
Technical Gaming & IT	320	320	320	566	887	763	714	714	714	714
Corporate Overhead	1,600	1,656	2,933	2,918	3,005	3,030	3,030	3,030	3,030	3,030
Total	13,596	14,688	16,514	20,608	23,206	22,423	22,264	22,027	21,692	21,546



Appendix C: Proposed Schedule of Fees

Product / Service	Current Fees	Proposed Fee	Annual Volumes
	\$ (GST incl.)	\$ (GST incl.)	
Class 3 Operator Licence			
New or renewal (prizes not exceeding \$50,000)	100	100	85
New or renewal (prizes exceed \$50,000 and all house)	707	707	15
Amendment	344	344	1
Class 4 Operator Licence			
New (Clubs, NZ Racing Board, racing clubs)	973	4,068	1
New (Other societies)	1,295	4,068	1
Amendment/Notification (Key Person)	344	636	95
Amendment/Notification (Other)	344	254	68
Renewal (Clubs, NZ Racing Board, racing clubs)	887	1,271	375
Renewal (Other societies)	1,123	2,543	65
Class 4 operator's annual compliance fee	3,566	4,063	65
Class 4 Venue Licence			
New (Clubs, NZ Racing Board, racing clubs)	543	763	10
New (Other societies)	608	1,017	250
Amendment/Notification (Key Person)	258	636	685
Amendment/Notification (Other)	258	254	1,600
Renewal (Clubs, NZ Racing Board, racing clubs)	372	127	380
Renewal (Other societies)	469	191	1,200
Class 4 venue annual compliance fee (per machine)	373	425	20,000
EMS Fee (per machine per day)	1.14	1.35	20,000
Licensed Promoter Licence			
New or Renewal	1,375	1,375	2
Temporary Authority	100	100	0
Certificate of Approval	270	328	400
Casino Operators Licence			
New	340,000	340,000	0
Amendment	1,000	1,000	0
Temporary Authority	23,000	23,000	0
Casino venue agreement			
New (including change of licensed operator)	23,000	23,000	0
Amendment	1,000	1,000	0
Associated person	330	330	10
Casino Operator's annual fee			
Sky City Auckland Casino	2,218,207	2,894,927	N/A
Sky City Hamilton Casino	548,184	733,513	N/A
Christchurch Casino	925,431	1,253,045	N/A
Dunedin Casino	477,394	556,895	N/A
Sky City Queenstown Casino	237,501	237,824	N/A
Wharf Casino (Queenstown)	216,259	221,434	N/A
Monthly penalty for non-payment of casino operator's annual fee	5%	5%	
Appeal Fees Filing	120	250	15
1 day hearing fee	450	450	N/A
Half day and part half day hearing (after first day)	450	450	N/A

Notes

1. The schedule of fees has been prepared in accordance with the legislation and Treasury *Guidelines for Setting Charges in the Public Sector*. In particular the guidelines provide that:
 - prices should be set at or below cost recovery;
 - prices should not be higher than the cost of delivering the service;
 - capital costs may be recovered through higher fees early in the life of the investment if there is a high degree of overlap between current and future users;
 - prices should be stable;
 - agencies must identify ways to keep costs down, consult and be open about costs;
 - fees should not constitute an illegal tax;
 - individuals who benefit should pay;
 - there should be no subsidisation of fees for activities under different statutes; and
 - there should be no third party funding of services to the Crown.
2. The proposed fee schedule was prepared on the basis of the following assumptions:
 - that the number of licensed class 4 operators (gaming machines) and venues will remain static at about 440 and 1,580 respectively;
 - that the number of gaming machines, following the decline following the enactment of the legislation and the introduction of electronic monitoring, will remain at approximately 20,000;
 - that, for the purpose of setting the EMS daily fee, 95% of licensed gaming machines will be operated on any day;
 - that there will be an increase in licensing and compliance activity due to the requirements of the Act;
 - that the number of applications by casinos each year for changes to licence conditions and appeals will not significantly increase;
 - that 400 applications for Certificates of Approval will be made annually by casino employees;
 - that the number of appeals to the Gambling Commission against decisions made by the Secretary will continue at the current level;
 - that the Department will continue to operate a Memorandum Account for gaming regulation to manage the recovery of costs over a number of years.
3. The proposed fees schedule anticipates the incorporation of the Gambling (Fees and Revocations) Regulations 2004 with the Gambling (Electronic Monitoring Fees) Regulations 2006. Where appropriate, licensing application fees include a portion of Gambling Commission costs to reflect the right of appeal against the Department's licensing decisions. Compliance-related fees also include a portion of the Gambling Commission costs to reflect the right of appeal against the Department's compliance decisions.
4. It is proposed that fees for the approval of a casino operator's licence, a casino venue agreement and the approval of an associated person will not change. It has been judged that these fees are either at the right levels or that there has been insufficient activity to judge whether the fees are appropriate.
5. Class 3 (large lottery and housie) and licence promoters licensing fees have been accurately calculated from activity estimates and a level of scrutiny that reflects the Department's compliance activity in these areas. No change is proposed for these fees.
6. The Act provides that fee regulations may specify the circumstances in which a penalty for default in payment is payable and may be remitted. In most cases failure to pay a fee will result in an application not being processed or a licence not being granted. However, casino operators' licences are granted for 25 years. The current 5% penalty for late payment of the casino operator's annual fee is considered an appropriate incentive for timely payment of this fee. The Department has yet to invoke this penalty.
7. The Act provides that certain gambling activities (private gambling, sales promotions, class 1 and class 2 gambling) may be conducted without a licence. While these forms of gambling are low-risk, it is anticipated that some compliance activity will be required. While benefiting the general public, compliance activity ensures that gambling is conducted lawfully and also benefits licensed gambling operators. The regulation of unlicensed gambling therefore does not meet the definition of a 'public good' and does not constitute a service to the Crown. Recovering the estimated \$150,000 cost of regulating unlicensed gambling from fees charged to licensed gambling operators is therefore consistent with the Treasury guidelines.

Appendix D– Recent History of Casino Regulation

PAST (Pre-Act)

- Prior to the Act, the Department’s regulatory functions in relation to casinos were limited to (1) an inspection role, focused mainly on internal controls, audits, patron complaints, and assisting in the detection of offences against the Casino Control Act (Casino Control Act 1990 (CCA), section 83) and (2) the issue of Certificates of Approval to certain casino staff (CCA, part III). Essentially it was a limited monitoring role, delivering only on narrow output requirements. For example, there was no emphasis on the prevention and minimisation of gambling-related harm. The Department operated an international best practice model in relation to its auditing functions, but it was very much within the parameters of the legislation.
- The Casino Control Authority (the Authority) likewise exercised its licensing and approval functions in a limited capacity. It focused on the licensing of casinos to promote “tourism, employment, and economic development” (CCA, section 5). In relation to harm prevention and minimisation, it had only to be satisfied that social impacts of the casino would not be “unduly negative” (CCA, section 30). It relied largely on external sources for technical advice, e.g. about game fairness and probity or equipment approvals. In relation to some of its functions (e.g. making game rules) there was no consultation requirement.
- The Department did not have a major role in Authority deliberations – for example it was seldom invited to make submissions on applications to the Authority.

CURRENT (Post-Act)

The current regulatory environment and compliance strategy

- The Department’s current compliance strategy is more integrated and holistic in its approach to casino regulation. It is driven by both the specific purpose of the Act and the Safer Communities outcomes of Government.
- The Act’s *purpose section* (section 3) encompasses broad themes relating to integrity and fairness, crime prevention and enforcement, and the prevention and minimisation of gambling related harm.
- In relation to *crime prevention and enforcement*, the Act mandates a broader role for the Department. In keeping with a whole of government approach, the Department has embarked on a series of cooperative initiatives with other enforcement agencies. In each case, the principals have been actively connected to gambling activity at New Zealand based casinos.
- The Act mandates a broad public health approach to *harm prevention and minimisation*. This means looking at factors influencing harm that are broader than the affected individual (e.g. family, community, gambling environments and products) and involves the Department in broad dialogue with community representatives, service providers, government agencies and the gambling sector about how harm can be prevented and minimised.
- The high level of public, commercial, government and media interest around casinos leads to *high stakeholder expectations* that the Department will be a sophisticated and competent regulator. Driving up the quality of regulatory practices has been central to the SOI for the past two years and that has included a strategic investment in casino regulation. The level of investment in policy, intelligence, investigations and stakeholder management, required to operate effectively within the casino environment, has significantly grown.
- The *public* (including those working in the problem gambling area) have high expectations of the regulator. We are expected to be knowledgeable on harm prevention and minimisation matters, to keep in touch with local communities, and to put in place appropriate and effective

interventions. Both the Department and casino operators have undergone a steep learning curve in respect of harm prevention and minimisation issues.

- In order to improve the quality of its regulatory practices and become an exemplar regulator, the Department needs to continually enhance its understanding of the requirements of *effective casino regulation in an international context*. The Department works closely with other government agencies, Australasian and other international jurisdictions, to enhance its enforcement, intelligence, and policy tools and learn from the example of others. The Department is also a member of the Australasian Casino and Gaming CEO Regulator's Forum and has staff participate in working parties supervised by this committee.
- Our drive to increase quality has increased the need for *support functions*, such as intelligence and investigations. There is also a significant requirement for specialists – both internal and external to the organisation.
- *Compliance and legal costs* have increased significantly due to the costly nature of enforcement action⁷ and the litigious nature of the casino sector as a whole. Legal costs are likely to increase further as a result of court action to resolve a number of areas of uncertainty in the Act. The Gambling Commission takes a very cautious and legalistic approach in its determinations, requiring a Department response that is fully supported by appropriate legal expertise. An increase in harm prevention and minimisation issues requiring legal input is also anticipated.

Casino regulatory functions under the Gambling Act

- The Act introduced a number of *functional changes* that had the effect of increasing the Department's workload in relation to casino regulation. A number of functions transferred from the Casino Control Authority to the Secretary for Internal Affairs. These included:
 - Making, amending and revoking game rules for casino games (section 367);
 - Making, amending and revoking minimum standards for gambling equipment used in casinos (section 327);
 - Making, amending and revoking minimum operating standards for casinos (section 141);
 - Approving casino gambling equipment (section 326);
 - Assessing the suitability of associated persons in relation to casino licences (section 149);
 - Other approval functions, including approval of group commission programmes, offsite storage of documents and gambling equipment, etc. (e.g. sections 177, 181).
- As well as these transfers of function, the requirements for exercising some of the functions changed substantially under the new legislation. Unlike the Authority, the Secretary is required to consult affected parties before making certain decisions (e.g. a decision on game rules or minimum standards) (section 372). The requirement to consider the purpose of the Act in exercising its functions means that the Secretary has to carefully analyse all applications in terms of that purpose. It also considerably extends the potential number of parties affected by a decision. For example, an application for a new minimum standard for a table game now requires a harm prevention and minimisation assessment. If there are possible harm prevention and minimisation implications, it is necessary to consult affected parties such as problem gambling service providers.
- The Secretary has taken a more rigorous approach to the *approval of casino equipment* than that formerly exercised by the Authority. Instead of relying on approvals from Australasian regulators, as the Department understands the Authority did, the Department ensures that each application is carefully assessed for compliance with the relevant New Zealand standard. This reflects the purposes of the Act, takes advantage of the technical expertise employed by the Department and brings casinos into line with class 4 gambling.
- The *functions and powers of inspectors* were extended to include detecting, investigating and prosecuting offences (not merely "assisting in detection") and to cover both Gambling Act offences and crimes involving dishonesty relating to gambling (Subpart 6). This has involved the

⁷ As demonstrated by the Dunedin Casino application for suspension of its licence

Department in a series of major investigations, both internally and involving other agencies (see below and Appendix F).

- Unlike the Authority, the *Gambling Commission*, which now exercises casino licensing functions, calls for submissions from the Secretary in relation to every application it hears. Considerable work is involved in the preparation and peer review of these submissions.
- While the Department took into account the major functional changes listed above in setting the fees in 2004 it proved difficult to anticipate what the costs to the Department would be in exercising those functions. It was necessary to rely on the then current information, e.g. Casino Control Authority financial data. However, the Authority could provide little detailed information to enable a functional breakdown of its costs. In any case, the practical effect of the changes in requirements for some of those functions was at that stage largely unknown.

Major investigations

- Illegal casinos potentially have a significant negative impact on a community in respect of the harm that can be caused through unregulated gambling. Organised crime, problem gambling and the proliferation of crime to meet gambling debts are all potential results from illegal gambling operations. Action to prosecute illegal casino operators protects the interests of all licensed gambling operators – casino and non-casino. Examples of the Department's results in this area are provided in Appendix F.
- In support of the crime prevention purposes of the Act and Government's Safer Communities outcome, we have supported police in the investigation of serious crime and initiated our own investigations where there is a direct link to gambling (more information in Appendix F).
- The Department has taken a strong stance on ensuring that casino operators meet their requirements to provide responsible gambling environments and adhere to harm prevention and minimisation obligations. To that end the Department has been involved in some significant investigations, along with the implementation of a strategic approach to making a positive difference to communities in this area. Investigations include the Keenan and Jackson cases (see Appendix F)

Inter-agency activities

- DIA is seen by other government agencies as the key player in the casino environment, with a requirement for strong linkages with other agencies. By contrast, most international jurisdictions have a dedicated gambling regulatory agency with a role that is confined to strict adherence to casino controls, as opposed to the broader approach taken by the Department. In some jurisdictions there is a separate policing arm attached to the regulatory function that oversees the criminal aspects of casino environment.
- DIA is expected to provide support and resource in respect of the monitoring of Financial Transactions Reporting Act requirements, and involvement with Police Financial Intelligence Unit. In addition it is a key participant in an international (APG) project on casino vulnerability to money laundering.
- There are expectations that we know well our Casino environment and can make strong contributions to significant inter-agency investigations. The time required for major operations can be significant.
- There is a clear expectation, reflected in the purposes of the Act, that opportunities for crime will be prevented. Further investment from us as a regulator will be required to progress what has been started in this area, particularly in regard to money laundering and other crime associated with gambling in casinos, and to ensuring that casinos are taking appropriate steps to prevent crime.
- The Department is undertaking a strategic intelligence project (project Metos) that involves an in-depth study of the current state of crime or suspected crime in NZ Casinos (Christchurch and

Auckland). The expectation of this work is that it will provide a sound basis from which to involve casino operators in implementing crime prevention strategies and to properly address any current crime concerns. There are international dimensions to the issues and DIA is demonstrating leadership within this context.

Benefits for Casinos arising from effective regulation

- Assurance that gambling is fair, lawful and has integrity for the community and casino patrons;
- The ability to work closely with the regulator in the progression of project Metos. Clear messages that the casino is working pro-actively and co-operatively with the Department to prevent gambling related crime support the casino as a reputable business and good corporate citizen;
- As casinos demonstrate a clearer intention to work more closely with the regulator to maximise compliance they stand to make reputational gains. As well there is opportunity for DIA to facilitate productive relationships with community groups and help agencies, in doing so ensuring the effectiveness of regulation;
- As overall compliance increases there is a lower likelihood of sanctions;
- As the regulator and the casinos are seen to be more in alignment with the outcomes of the Act there will be greater confidence by overseas investors to invest in casinos. New Zealand will be viewed as a “safe” regulatory environment and casinos’ commercial viability will be enhanced.

Appendix E: Recent History of Non-Casino Regulation

Past (Pre-Act)

Prior to the Act, the New Zealand non-casino gaming machine sector was regulated largely by a single section of the Gaming and Lotteries Act (section 8). Operators had to obtain a licence to operate gaming machines, and beyond that there were few statutory requirements other than those that applied to all forms of gambling. The Government did not have a clearly stated, detailed policy on the regulation of gaming machines. The legislation did not robustly address the high degree of risk associated with gaming machines (including risk of crime and unfairness to players) and was silent on the issue of gambling related harm.

In the absence of clear statutory direction, decisions on gambling regulation were largely subject to internal policy and operational decisions of the Department, and the regime went through a rapid series of changes. Detailed requirements set out in licence conditions addressed some risks, but were vulnerable to challenge as they did not have the force of statute. The Department's ability to scrutinise operators in detail was also limited by the legislation. Many gaming machine and venue operators took advantage of this uncertain environment to make significant personal gains from operating gaming machines. The number of licenses issued continued to grow during this time. At 30 September 2000 there were 877 licensed operators.

From mid 2002 the Department began to focus strongly on enforcement and deterrence, for the purpose of raising operational integrity and awareness throughout the sector. This resulted in significant numbers of suspensions and cancellations of operator and venue licences between 2002 and 2004. This approach went hand in hand with an increased focus on preventive work such as education and persuasion aimed at achieving voluntary compliance. A risk based approach and enforcement strategy, based on a "regulatory pyramid" and using a range of tools, was introduced to ensure that compliance activity and interventions was focused at an appropriate level.

Current (Post Act)

When the Act came into effect, the Department's main focus became highly operational - implementing the new requirements and ensuring that the sector understood them. Greater emphasis was placed on educating the sector, while maintaining enforcement activity as required. As a greater level of understanding was achieved, the Department began to shift its emphasis to achieving outcomes, particularly around society governance, minimising society expenditure, ensuring money is returned to the community, and harm prevention and minimisation.

In line with this strategic shift, voluntary compliance principles became embodied in most areas of the regulatory process. Significantly more time is now invested in interventions that are designed to facilitate voluntary compliance. This approach enables small operators, such as clubs, who may struggle with complex licensing requirements to achieve compliance. It is important to note that the volume of compliance work does not correlate to machine numbers. The work involved in helping gambling operators can, in some cases, be in inverse proportion to the size of the gambling operation. For example, in licensing alone, the Department has approximately 8 dealings with clubs daily, ranging from detailed assistance with financial viability statements and other information required to obtain a licence, to more general advice around gambling operations. The number of venue visits has also increased. A general assessment is that the majority of all time spent by inspectors with clubs is spent in education, support and facilitation.

Voluntary compliance is ineffective unless it is underpinned with effective intelligence, information, investigation and enforcement of serious non-compliance. The Department has expanded its intelligence and large-scale investigations capacity through the establishment of dedicated Intelligence and Investigations Units.

The Act requires us to cast a wider net to ensure that class 4 operations are legitimate. Examples of new or increased work imposed by the Act include:

- the requirement to be satisfied of the suitability of all key persons in relation to operators and venues (Sections 52, 67) involves a large number of probity checks;

- in-depth checks of “management companies” contracted to societies to assess whether they are key persons and ensure that their activities and the payments they receive are legitimate
- The Department now audits a sample of grant recipients to ensure that grants are legitimate and used for the purposes they were sought (section 332);
- the requirement to assess the financial viability of societies (section 52). This can involve lengthy investigations;
- the need to check compliance with a number of harm prevention and minimisation requirements (e.g. Subpart 2, Gambling Act (Harm Prevention and Minimisation) Regulations 2004);
- the need for increased data and information to guide strategic and operational policy work.

The level of scrutiny will increase still further to address recommendations made by the Auditor General in its 2006 review of the Department’s (Class 4) regulatory practices.

The compliance audit has been completely changed to reflect the principles and requirements of the Act. Instead of taking a “tick box” approach, audits now place greater emphasis on the governance and accountability mechanisms of class 4 gambling operators, with a focus on improving practice. Instead of working solely with the society’s operational managers, inspectors also work directly with the boards of societies, making them accountable for compliance in line with their fiduciary duty. Investigating accountants undertake in-depth analysis of the society’s financial viability, accounting practices, and cash flow.

The sanctions process is also more labour intensive under the new Act. In order to justify imposing a sanction, the evidence must be checked to ensure that it meets a standard that would satisfy the Gambling Commission on appeal. The sanction itself must be reasonable and proportionate. A sanctions committee meets regularly to discuss and advise the delegated decision maker on proposed sanctions. The work involved in considering a society’s response to a proposed sanction has significantly increased. In some cases the sanctions process takes longer than it took to complete the audit or investigation that resulted in the sanction.

The appeals process imposes a completely new strand of work including briefing legal advisors, preparing submissions and affidavits, and in some cases adjusting process and policy documents to reflect Commission decisions.

We are engaging with the community at a local level in line with the public health and community involvement themes of the Act and the need to better inform our regulatory strategy.

The introduction of EMS has resulted in an increase in inquiries and the establishment of the EMS helpdesk.

Benefits of the new approach

- Sector representatives and Departmental staff have commented favourably on the effectiveness of the new audit approach;
- Improved sector relationship resulting from better information, more transparent audit process, and the voluntary compliance strategy, has resulted in a reduction in conflict and potential legal expenses;
- With this level of scrutiny societies on the “margin” of compliance have either gone (licence not renewed) or merged with a better performing society.

Appendix F: Major Investigations (some examples)

Operation Havana: An illegal casino operating in the Wellington region resulted in the closure of the gambling operation, along with a number of arrests for illegal gambling.

Operational Jemima - Illegal Casinos – this was a combined agency operation and resulted in the closure of Asian illegal gambling operation. A number of offenders were prosecuted

Keenan Case – Dunedin – as a result of Keenan gambling her own and stolen money in the Casino and the failure of the Casino to effectively implement responsible gambling practices as required, it was found that at the Dunedin Casino breached its harm minimisation requirements and was required to close for 2 days as a result.

Jackson Case – Skycity Casino Auckland – as a result of Jackson gambling a vast sum of stolen money at SkyCity, the Department undertook a significant patron complaint investigation into SkyCity's actions in respect of its harm minimisation requirements. While the outcome was that SkyCity had not technically breached the Gambling Act, the Department has made several recommendations for change and will expect a significantly higher level of performance from SkyCity following this investigation. This includes the expectation that casino systems will support investigations into actual or potential problem gamblers, a recommendation that is strongly endorsed by gambling help agencies. The type of work described attracts a significant resource investment due to the nature and severity of any potential enforcement action that may result. There is a requirement that these costs are reflected in casino fees, and there is an expectation that as casinos attain compliance with their harm minimisation requirements costs will reduce.