



Performance audit report

Department of
Internal Affairs:
Effectiveness of
controls on non-
casino gaming
machines





Office of the Auditor-General
Private Box 3928, Wellington

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

E-mail: reports@oag.govt.nz
www.oag.govt.nz

Department of Internal Affairs: Effectiveness of controls on non- casino gaming machines

This is the report of a performance
audit we carried out under section
16 of the Public Audit Act 2001.

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Foreword

I felt it timely to review the effectiveness of controls on non-casino gaming machines because of the large amount of money placed in the machines (estimated by the Department of Internal Affairs at more than \$8,500 million annually), the potential for the machines to cause harm in the form of problem gambling, the amount of funds from the machines going to clubs and the wider community, and a relatively new legislative framework covering gambling.

The Department of Internal Affairs administers controls on non-casino gaming machines. My review focused on three main areas of controls. These were the controls on licensing of non-casino gaming machine operators and venues, on operator and venue costs, and on the distribution and application of funds to the community including through grants.

I found that the Department of Internal Affairs has extensive policies and procedures for licensing and auditing of venues and operators, and a risk-based approach to compliance. However, there were areas of its policies, procedures, and practice that did not meet all of the requirements of the Gambling Act 2003. These included its procedure for renewing licences and for auditing. I also found that its licensing staff were issuing and renewing licences without the necessary delegated authority. The Department has committed to rectifying this issue, and had largely done so at the time this report was being finalised.

While the Department of Internal Affairs has committed to comprehensively monitoring the outcomes being achieved in the non-casino gaming machine industry, it is not yet doing this in a systematic or comprehensive manner. This limits the Department's ability to demonstrate the results of its work and refine the way it works to achieve better outcomes.

I thank staff in the Department of Internal Affairs for their assistance, responsiveness, and co-operation during the audit. I also thank people in the industry who generously gave their time and views during the audit.

The Department has been very engaged in, and supportive of, the audit process. Its commitment to implementing the audit findings to make improvements is pleasing.



K B Brady
Controller and Auditor-General

14 February 2007

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Glossary

In some cases, the definitions in this Glossary are a simplified version of those in the Gambling Act 2003. Refer to that Act for complete definitions.

Apply funds: The main method used by operators, usually a club, to grant net funds obtained from gaming machines to the authorised purposes of their own organisation. This is different from distributing funds where the funds are directed to the wider community, rather than to the operator's own authorised purposes.

Audit: The systematic examination of any or all of a gaming machine venue's and/or operator's policies, procedures, practices, and records.

Authorised purpose: For non-casino gaming machines, a charitable purpose or a non-commercial purpose that benefits the whole or a section of the community. It also includes promoting, controlling, and conducting race meetings under the Racing Act 2003, including the payment of stakes.

Class 4 gambling: The meaning in section 30 of the Gambling Act 2003. It includes gambling that involves net proceeds being applied to, or distributed for, authorised purposes; that no person pays nor receives a commission for conducting; that satisfies relevant game rules; and that uses or involves a gaming machine.

Compliance: Conformity with the requirements of the law and any licence requirements.

Controls: The means used to promote, direct, restrain, govern, and check various activities.

Distribute funds: The main method used by operators to direct net funds obtained from gaming machines to authorised community purposes, usually by grants. This is different from applying funds, where the funds are directed to an operator's own authorised purposes, rather than to the wider community.

Grant: A method of payment used to distribute net funds obtained from gaming machines to the community.

Inspection: A visit by Department of Internal Affairs staff to a gaming machine venue, to compare aspects of the venue's operation with the requirements of the Gambling Act 2003.

Investigation: An enquiry by the Department of Internal Affairs that may go into more detail than an audit, and that can involve third parties and areas falling outside of the scope of an audit. An investigation seeks to determine the substance of complaints or information received, or whether an offence has been committed.

Key person: For operators, the chief executive (or equivalent person), a person who is a trustee or other officer of the operator, and any other person who exercises a significant influence in the management of an operation that is an applicant for, or holder of, a licence.

For venues, see section 2 of the Gambling Act 2003 for a full definition. It includes a venue manager, venue personnel, a venue operator, a director, chief executive or senior manager of a venue operator, and any person contracted to service gaming machines at the venue.

Net proceeds: See section 2 of the Gambling Act 2003 for a full definition. In summary, it means the funds available for application or distribution to authorised purposes.

Operator: An organisation that holds a licence under the Gambling Act 2003 to operate gaming machines in a venue or venues other than casinos.

Society: An association of persons established and conducted entirely for purposes other than commercial purposes.

Venue: A physical location outside of a casino where gaming machines are operated.

Background

Non-casino gaming machines are devices that are totally or partly mechanically or electronically operated for use in gambling in venues other than casinos. They are commonly known as “pokie” machines.

The Department of Internal Affairs (the Department) estimates that about \$8,500 million (including GST) was spent in 2004/05 in non-casino gaming machines. The Department estimates that about \$7,500 million (including GST) of this total was returned to gamblers as winnings, and about \$384 million (excluding GST) was given to the community. The remainder goes to taxes and charges, and to the operating costs of operators of the machines and venues where the machines are located.

The Gambling Act 2003 (the Act) sets out the legislative framework for controls on non-casino gaming machines. The Department is responsible for administering the Act.

What we audited

We focused on the effectiveness of the Department’s policies, procedures and practices for ensuring that:

- non-casino gaming machine operators and venues are licensed – this is to ensure that only those persons and organisations who meet the requirements of the Act are able to enter and remain in the non-casino gaming machine industry (the industry);
- non-casino gaming machine operator and venue costs are appropriate – this is because inappropriate costs reduce the funds subsequently available to the community; and
- funds are distributed or applied to authorised purposes, including through grants – if funds are used for other purposes, they are not benefiting the community in the manner intended by the Act.

We did not examine the flow of funds to the community, the effect or use of the funds in the community, or the Department’s oversight of harm-minimisation activities.

Our findings

Although the Department’s strategic approach to compliance is still emerging, the fundamental elements we expected the Department to have were in place. The Department has extensive policies and procedures covering its licensing and audit

activities, and a risk-based approach to compliance. However, the Department could improve, particularly in consistency of practice and consistency of policies and procedures with the Act.

Licensing non-casino gaming machine operators and venues

As at 30 June 2006, there were 496 licensed operators. Of these, 73 were societies (who generally distribute funds to the wider community) and 423 were clubs (who generally apply funds to the club's own authorised purposes).

The Department has a comprehensive licensing manual that outlines policies and procedures. It also has a systematic process for amending licensing policies and procedures. However, some aspects of its policies, procedures, and practice did not comply with the Act. Its shortened procedure for renewing licences did not allow the Department to be satisfied that all the necessary requirements of the Act had been met before a licence was issued. Another breach of legislation we found was that licensing staff were issuing and renewing licences without the necessary delegated authority. The Department treated the delegations issue as serious, sought appropriate legal advice, and is acting on that advice.

There are also some minor administrative inconsistencies between the Department's practice and its policies and procedures.

In our view, the procedure used by the Department to require applicants to maximise net proceeds by stating at the time of licence application how they will maximise the funds available for the community is weak.

There have been significant delays in finalising annual licences for some societies and clubs.

Monitoring and enforcing compliance

The main tools used by the Department to enforce operating and venue costs rules are audits, investigations, and education. Whether an audit is conducted is determined by the Department's risk profiling of operators. Operators assessed as high risk are audited.

The focus on audit of high-risk operators, with no random audit of other operators, is the same situation we found in our 1998 audit. After the 1998 audit, Cabinet required the Department to audit 50% of operators every year. This requirement was rescinded in 2003.

Where the Department does not have current information for a given risk factor, it makes assumptions about the level of risk. We noted some inconsistencies in these assumptions. In our view, the Department has made a judgement on the

relative risks of societies and clubs without definitive information on differences in their actual levels of compliance.

We observed that the definition of high risk had changed from year to year. The number of audits included in the audit work programme has reduced over time. The actual number of audits undertaken by the Department is not clear from the Department's activity reporting due to the types of measures used.

In our view, there is a risk that, by doing fewer audits, the Department gathers less information about entities. This means fewer meet the threshold of high risk to warrant an audit, which leads to a further reduction in audit activities. The Department has identified this as an issue.

Policies and procedures exist for auditing venues and operators. An audit checklist and manual are the main resources used by staff.

The audit manual does not contain guidance on how to assess whether operator expenses are reasonable. The Department has identified this as an issue. We believe the Department needs to do more to provide such guidance. Until it does, this will remain an area where significant benefits to the community could be lost.

We found some inconsistencies in the manner in which Department staff implemented policies and procedures when conducting audits. We also found the Department's audit checklist and manual were not consistent with the requirements of the Act.

Compliance of grant processes and payments

Operators use grants to distribute funds to authorised purposes. The processes operators use for making grants vary in sophistication. The type of grants operators make also varies widely, reflecting operators' different authorised purposes. Some operators make grants for only a single purpose (for example local rugby), while others will consider applications from community groups throughout New Zealand for a wide range of activities.

The Department uses audits and investigations to monitor grant processes and grant payments.

Examples of issues found by the Department in audits were:

- grants that did not fit an operator's statement of authorised purpose;
- recipients using funds for other than stated purposes;
- differences between actual and published grant information; and
- total grants being less than the minimum level of 37.12% of GST-exclusive gross proceeds.

The Department conducts surveys on the allocation of grants across the industry every few years.

Conclusion

Until the Department has more information on the level of compliance within the industry, it is not possible for us or the Department to make a reliable assessment of the extent to which the Department's approach contributes to the industry's compliance with the Act. In our view, the Department should accelerate work on outcome measurement. This is because of the importance of the work in demonstrating to stakeholders the results being achieved by the Department. It is also because of the importance of outcome information in contributing to the Department's understanding of the effect of its work as well as determining the focus of its work.

Our recommendations

We recommend that the Department of Internal Affairs:

Licensing

1. ensure that complete licensing and audit information is available in its information system (Licence Track), and that staff check this information during licensing and relicensing of non-casino gaming machine operators and venues;
2. review and change its policy and practice for considering non-casino gaming machine licence applications, so the checks are enough for the Secretary for Internal Affairs to discharge their obligations under the Gambling Act 2003 when issuing a new operator's or venue licence or renewing an operator's or venue licence;
3. review and amend the key person checks it undertakes when considering non-casino gaming machine licence applications, so the checks are enough for the Secretary for Internal Affairs to discharge their obligations under the Gambling Act 2003 when issuing a new licence or renewing a licence;
4. periodically (for example, annually) review self-disclosure rates against the requirements of sections 54 and 71 of the Gambling Act 2003, and use this information to improve future self-disclosure rates;
5. strengthen its processes for ensuring that the Secretary for Internal Affairs is satisfied that non-casino gaming machine licence applicants will maximise net proceeds;
6. introduce a quality review of non-casino gaming machine operator's and venue licences before the licences are finalised and issued;

7. give priority to resolving non-casino gaming machine operator's licence applications that have been outstanding for more than one calendar year;

Operator and venue costs

8. accelerate work on outcome measures relating to compliance within the non-casino gaming machine industry;
9. improve its controls over gambling inspector or manager adjustment of a non-casino gaming machine operator's overall risk profile rating;
10. reduce the level of missing information about non-casino gaming machine operators within its risk-profiling system, and improve the consistency of assumptions about operator risk in the absence of current information about operators;
11. improve information in its planning and accountability documents by stating the quantity of work the Department will undertake for its chosen audit risk threshold for operators, and indicate the expected contribution of this work to compliance in the non-casino gaming machine industry;
12. continue to closely scrutinise and improve, where necessary, its recording and reporting of the volume of activities that it has undertaken related to non-casino gaming machine operators (such as audits, investigations, and sanctions applied), and corrects any activity information already in the public arena that it determines is incorrect;
13. differentiate between different sizes of audits of non-casino gaming machine operators, include the full time taken for audits in its performance recording, and reflect these in its accountability documents;
14. develop guidance on reasonable non-casino gaming machine expenses by making better use of the information it already collects and, where necessary, by gathering more information;
15. review its non-casino gaming machine Audit Checklist and Audit Reference Materials manual against the specific requirements of the Gambling Act 2003, review the information gambling inspectors need to meaningfully assess compliance with these requirements, and amend the checklist and manual accordingly;
16. enhance its management of compliance staff independence risks so gamblers, the Department of Internal Affairs, its staff, and the non-casino gaming machine industry are better protected from these risks; and

Grants

17. provide its staff with clear guidance on the extent of its responsibilities for grants and non-casino gaming.

Part 1

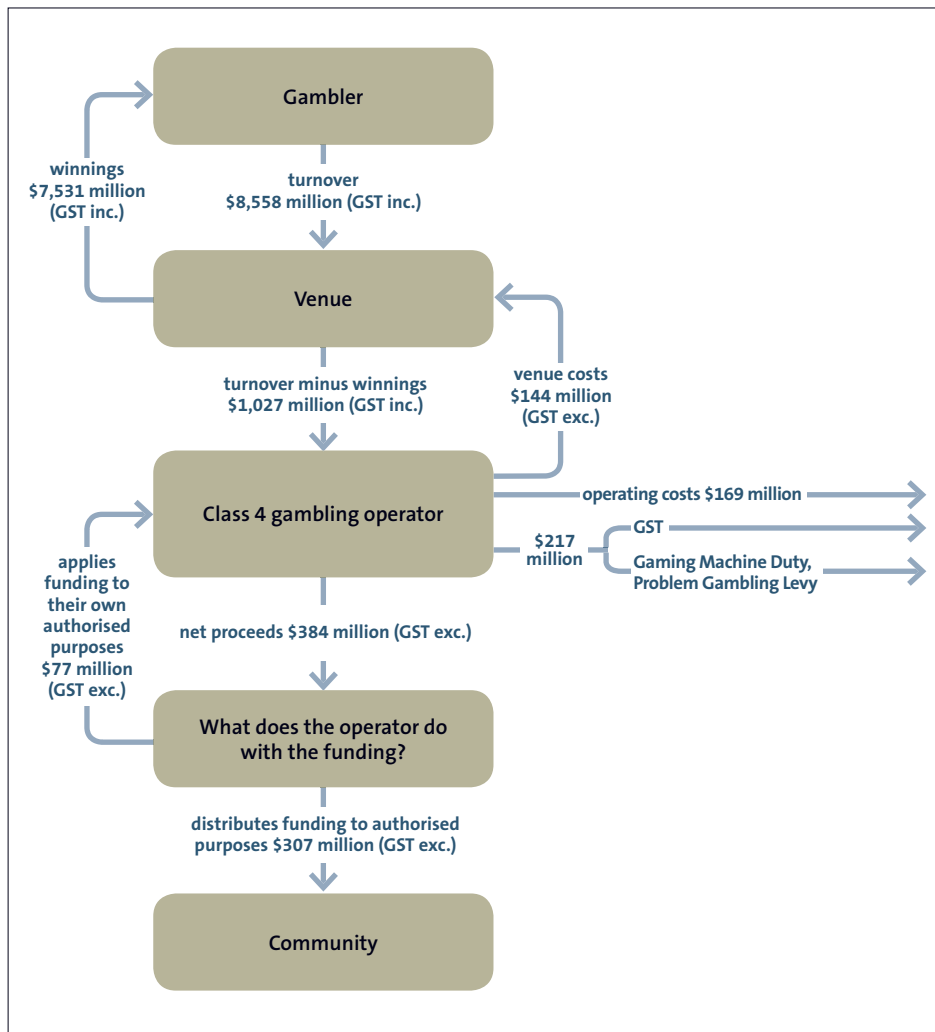
Non-casino gaming machines and our audit

What are non-casino gaming machines?

- 1.1 Non-casino gaming machines are devices that are totally or partly mechanically or electronically operated for gambling in venues other than casinos. They are commonly known as “pokie” machines, and are usually located in hotels or clubs.
- 1.2 The Department of Internal Affairs (the Department) estimates that about \$8,500 million (including GST) was spent in 2004-05 in non-casino gaming machines. The Department estimates that about \$7,500 million (including GST) of this total was returned to gamblers as winnings and about \$384 million (excluding GST) was given to the community (including clubs returning funds to their own community purposes).¹ The remainder goes to taxes and charges (GST, Gaming Machine Duty, and Problem Gambling Levy) and to the operating costs of operators of the machines and the venues where the machines are located.
- 1.3 Funds from non-casino gaming machines are provided to the community in two ways:
 - through grant arrangements with operators that provide funds to community groups for certain purposes. Under these arrangements the operators distributing the funds do not directly benefit from them. These operators are said to “distribute” funds for authorised purposes; and
 - through funds being returned to the operators of the machines in addition to any operating costs received by the operators. These operators are generally clubs, and are said to “apply” funds to their own authorised purposes.
- 1.4 Some operators may both distribute and apply funds.
- 1.5 The Department estimates that, in 2004/05, about \$307 million (excluding GST) was distributed to the community and about \$77 million (excluding GST) was applied to operators in the community.
- 1.6 Figure 1 summarises what happens to funds placed in a non-casino gaming machine. It shows information for the 2004/05 financial year.
- 1.7 The non-casino gaming machine industry (the industry) is consolidating. Some of the main trends include decreasing numbers of operators, venues, and machines. Until 2004/05, there was a rapidly increasing amount of money spent on non-casino gaming machines.

1 We have not attempted to verify these figures as part of our audit because they are being used to provide context only. The figures include “churn”. Churn refers to reinvestment of funds during a gaming session. For example, if a player puts \$20 into a gaming machine, wins \$10 of this back, and then places \$5 of the winnings in the machine, the player would have put a total of \$25 into the machine and have \$10 in winnings, a net loss of \$15. In the figures above, the turnover for this example would be recorded as \$25 rather than the net loss of \$15.

Figure 1
Estimated funding flows from the gambler to the community in 2004/05



Notes:

- Figures are estimates provided by the Department of Internal Affairs. We have not verified these figures as part of our audit.
- Figures do not add exactly due to rounding to the nearest million.
- Turnover and winnings figures include churn. Churn refers to reinvestment of funds during a gaming session.
- Calculation of winnings assumes an 88% win ratio.
- Calculation of venue costs assumes that 80% of proceeds are attributable to public venues and venue payments at 19.7% of turnover.
- Calculation of taxes and levies assumes tax of 20% and levies of 1.11%.
- Calculation of returns to the community assumes that 42.032% of turnover minus winnings are returned, with 20% of that being applied and 80% being distributed.

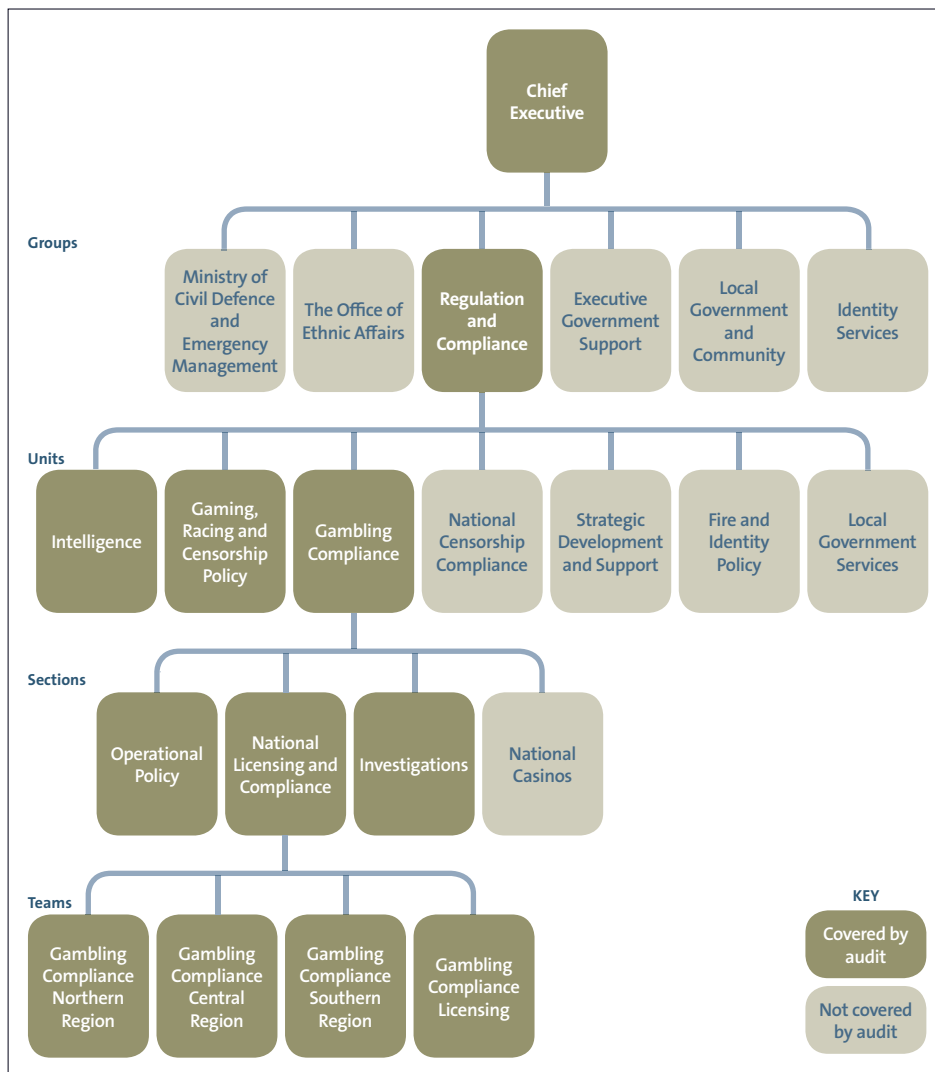
- 1.8 There has been a small reduction in estimated player losses (the total difference between funds placed in a machine and winnings paid out) from \$1,035 million (including GST) across all operators for operators' financial years ending in 2004 to \$1,027 million (including GST) for operators' financial years ending in 2005. The Department believes that player losses in 2005/06 were about \$900 million (including GST), and that player losses will remain steady at about this amount.
- 1.9 We have not attempted to investigate how consolidation might be related to the introduction of the Gambling Act 2003 (the Act) because:
- this is a large and complex question that is outside the scope of our audit;
 - not all aspects of the Act are fully implemented yet; and
 - some consolidation was occurring before the Act was passed.
- 1.10 To illustrate the longer term trends in non-casino gambling, since 2001 there has been about:
- a doubling of the average total estimated gamblers' losses for each gaming machine;
 - a tripling of the average total estimated gamblers' losses for each venue; and
 - a quadrupling of the average total estimated gamblers' losses for each operator.
- 1.11 Because of the very large amount of funds involved and the potential for gambling to cause harm, it is important that effective controls are in place for managing non-casino gaming machines.

What is the role of the Department of Internal Affairs?

- 1.12 The Act sets out the legislative framework for controls on non-casino gaming machines. The Department is responsible for administering the controls in the Act.
- 1.13 The principal control is the licensing of operators of gaming machines and the venues where the machines are located. The Department is responsible for issuing and renewing these licences. It charges fees for them. The fees are used to fund the Department's licensing and compliance activities.
- 1.14 The Department is also responsible for monitoring and enforcing compliance with the licence conditions and subordinate legislation. The Department's Gambling Compliance Unit undertakes this work as well as the licensing work. As at 24 January 2007, the unit had 50.5 full-time equivalent positions.

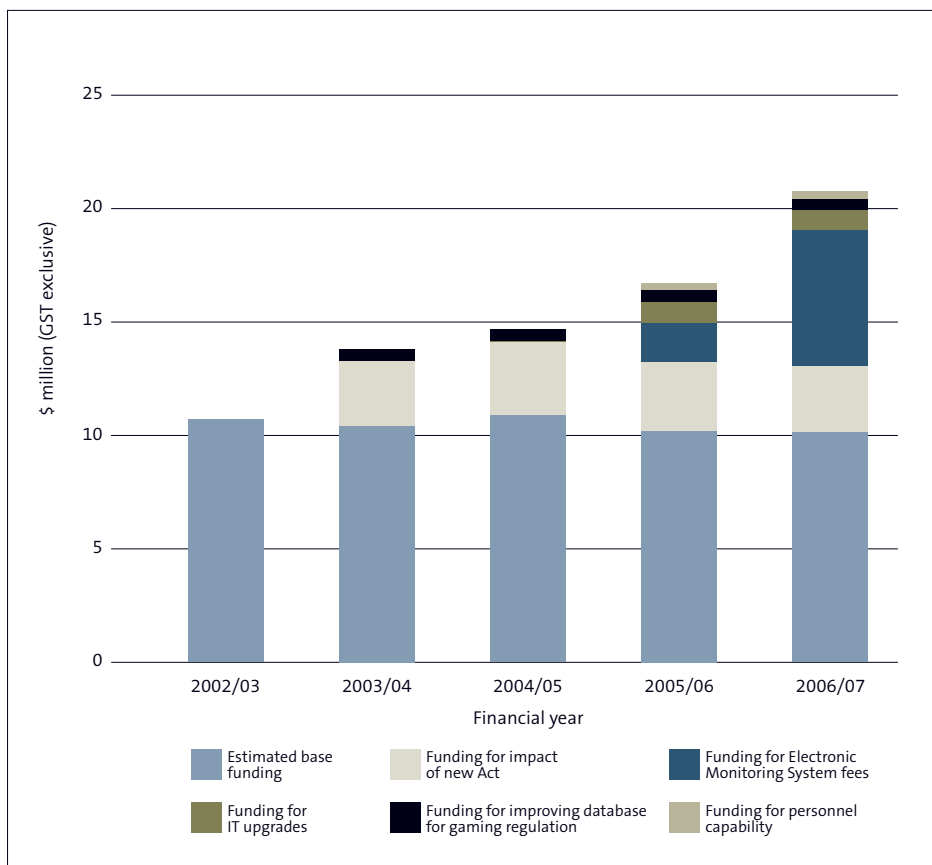
1.15 Figure 2 sets out the Department’s organisational structure, and shows the group, units, sections, and teams covered by our audit. Staff in the Gambling Compliance regional offices work almost exclusively on non-casino gaming machines and not on other forms of gambling.

Figure 2
Organisational structure of the Department of Internal Affairs



1.16 Figure 3 shows the funding received by the Department for all gambling (including casino and non-casino gambling) and associated regulatory activities, and the additional funding made available to the Department for the costs of the impact of the new Act and associated initiatives (mainly information technology initiatives).

Figure 3
Funding for gambling and associated regulatory services 2002/03 to 2006/07



Note: Total funding is as reported by the Department to us for this audit. Base funding is estimated by subtracting funding for specific initiatives, as recorded in the Estimates of Appropriations, from the total gambling and associated regulatory activities funding reported to us by the Department.

Gambling Act 2003

- 1.17 The Act is relatively new, having come into force in 2004. At the time of our audit, not all of the provisions of the Act and regulations under the Act (for example, those relating to an Electronic Monitoring System) were fully implemented. To implement the Act, the Department had to do a lot of work in a short time, particularly in licensing.
- 1.18 The Act replaced the Gaming and Lotteries Act 1977 and the Casino Control Act 1990. According to the Department, the Act “makes it much harder to get a gaming machine licence and much easier to lose it” compared with the previous legislation.

Electronic monitoring

- 1.19 Electronic monitoring of gaming machines (EMS) had not been fully implemented at the time of our audit. All operators must have their machines connected by March 2007. We did not audit EMS, as it is not yet fully implemented. EMS should allow the Department to –
- *monitor how much money is gambled on each gaming machine*
 - *monitor how much money each machine pays out in prizes to gamblers*
 - *monitor how much money should be banked*
 - *ensure that all software being used on machines is identical to the approved versions*
 - *assist in detecting software failures*
 - *assist in detecting tampering with a machine or software.*²
- 1.20 In effect, EMS will automate the collection of information that is currently collected manually. EMS will not assist with compliance activities relating to venue or operator expenses, operators’ grant processes, or the use of grants by recipients.
- 1.21 Until EMS is in place, turnover from non-casino gaming machines will continue to be recorded manually using information displayed on meters in the machines.

Findings of our previous audits

- 1.22 In 1992, we published a report – *Department of Internal Affairs: Control of Gaming under the Gaming and Lotteries Act 1977.*³ The report highlighted the need for increased monitoring of gaming machine operations by the Department. It also found that the Department had recognised the need for specific legislation to enable it to control gaming machines.

2 *Gambits*, Department of Internal Affairs, December 2004, page 17.

3 ISBN 0-477-02845-9.

1.23 We undertook a follow-up review in 1998.⁴ The review recommended a new legislative framework and a better balance in the Department's gaming machine compliance activities. At the time, the Department focused on auditing operators considered high risk and did no random auditing of other operators. The review also found that, at that time, the Department was not spending all of the money it received from annual gaming machine licence fees on gaming machine compliance, despite this being the purpose of the fees. It therefore potentially had funding available for more auditing work.

1.24 In our view, our current audit of the Department's controls on non-casino gaming machines was timely, given these past findings and the enactment of the Act.

How we approached this audit

1.25 We examined the effectiveness of the Department's controls on non-casino gaming machines. We focused on three main areas of the Department's controls. These are the effectiveness of the Department's policies and procedures for ensuring that:

- non-casino gaming machine operators and venues are licensed – to ensure that only those persons and organisations who meet the requirements of the Act are able to enter and remain in the industry;
- non-casino gaming machine operator and venue costs are appropriate – this is because inappropriate costs reduce the funds subsequently available to the community; and
- funds are distributed or applied to authorised purposes (under the Act), including through grants – if funds are used for other purposes, they are not benefiting the community in the manner intended by the Act.

1.26 Specifically, we examined whether:

- intelligence and a risk-based approach inform the application of policies and procedures;
- the policies and procedures are consistent with the relevant requirements in the Act;
- the policies and procedures are followed by the Department; and
- the policies and procedures are periodically reviewed and updated.

1.27 To examine the effectiveness of the Department's controls, we used complementary sources of evidence. These included:

- interviewing a range of the Department's staff in its national and three regional offices, operators, a Gambling Commission representative, and industry organisations;

⁴ *Third Report for 1998*, parliamentary paper B.29[98c], pages 53-72.

- examining the Department's documents, including reviewing files held in the Department's national and regional offices;
- reviewing a sample of selected operators' licence applications or renewals against the Department's stated policies and procedures; and
- observing some of the Department's processes in action.

1.28 Our audit focused on the Department's policies and procedures that help ensure that funds return to the community. We did not examine the actual funds going to the community or the use of or effect of the funds in the community. These were outside the scope of our audit. We also did not examine the Department's oversight of activities to minimise harm from gambling in the sector. These activities are worthy of separate study.

1.29 The Department told us that it has "no role in determining the specific authorised purposes that funds are used for". It is up to operators to determine the actual recipients and specific uses of funds within the broad purposes in the Act and within the statements of authorised purpose approved by the Department.

Part 2

Controls on non-casino gaming machines

- 2.1 In this Part, we focus on the controls on non-casino gaming machines. The rules on non-casino gaming machines are set out in the Act and subordinate legislation. The tools used to enforce these rules are the licensing and compliance interventions used by the Department.
- 2.2 We focus on the rules in the Act because non-casino gaming machines are highly regulated, with relatively prescriptive requirements that operators of such machines must comply with to operate lawfully. Operators need a relatively high level of business ability to fully comply with these requirements.

Gambling Act 2003

- 2.3 The Act is at the core of a new legislative framework for gambling. Most of the Act's provisions came into force on 1 July 2004. There were some amendments to the Act in 2005.
- 2.4 The main pieces of subordinate legislation are the Gambling (Class 4 Net Proceeds) Regulations 2004, Gambling (Harm Prevention and Minimisation) Regulations 2004, and the Limits and Exclusions on Class 4 Venue Costs Notice. Several other regulations also affect or relate to non-casino gaming machine operators,¹ for example by prohibiting the offer of certain prizes to gamblers.
- 2.5 The purposes of the Act are to:
- control the growth of gambling;
 - prevent and minimise the harm caused by gambling, including problem gambling;
 - authorise some gambling and prohibit the rest;
 - facilitate responsible gambling;
 - ensure the integrity and fairness of games;
 - limit opportunities for crime or dishonesty associated with gambling;
 - ensure that money from gambling benefits the community; and
 - facilitate community involvement in decisions about the provision of gambling.
- 2.6 The Act does not identify any of its purposes as being more important than others. The Department therefore has to determine the appropriate balance between ensuring that benefits are derived from gambling and ensuring that the harm from gambling is controlled. This is a difficult balance, and there are a range of views as to how this balance should occur.

¹ For example, the Gambling (Infringement Notices) Regulations 2004, Gambling (Electronic Monitoring Fees) Regulations 2006, Gambling (Forms) Regulations 2004, Gambling (Problem Gambling Levy) Regulations 2004, Gambling (Fees and Revocations) Regulations 2004, and Gambling (Prohibited Property) Regulations 2005. The Gambling (Class 4 Banking) Regulations 2006 were not in force at the time of our audit.

Operator's and venue licences

- 2.7 The Act classifies gambling into six classes. Use of non-casino gaming machines is the only gambling activity currently in class 4.
- 2.8 Class 4 gambling may be conducted only by a corporate society (operator). To operate class 4 gambling, an operator must have a:
- class 4 operator's licence; and
 - class 4 venue licence for each venue where a gaming machine or machines are operated.
- 2.9 The requirements an operator has to meet to the satisfaction of the Department to obtain an operator's licence include:
- Their purpose is to raise money for authorised purposes.
 - They are financially viable.
 - They will maximise net proceeds and minimise operating costs.
 - They will apply or distribute net proceeds for authorised purposes.
 - They will minimise the risks of problem gambling.
 - They are a suitable applicant and have suitable key persons.
- 2.10 Conditions an operator has to meet to the satisfaction of the Department to obtain a venue licence include:
- They have territorial authority consent (where required).
 - They will minimise the possibility of persons under 18 years old gaining access to the venue.
 - They will minimise the risks of problem gambling.
 - They hold a class 4 operator's licence.
 - They have a suitable venue manager.
- 2.11 The Act restricts the number of gaming machines at any one venue, and enables local authorities to also impose conditions on the number of machines at a venue in certain circumstances.

Operator and venue costs

- 2.12 Of the total revenue generated from non-casino gaming machines, machine operators are allowed to retain some for certain operating costs and to pay venues certain costs. A Gazette Notice imposes limits and exclusions on the costs that can be paid to venues by operators. The limits are:
- Limit A – no more than \$0.60 for each gaming machine for each hour of gaming machine operation for labour, electricity, and associated management fees;

- Limit B – no more than \$75.00 for each gaming machine for each week for weekly labour machine management tasks, rent or lease payments, insurance, interest, and associated management fees;
- Limit C – no more than \$800.00 for each venue for each week for weekly labour venue tasks, security, venue development and/or enhancements and/or maintenance, and associated management fees; and
- Limit D – no more than 16% of the turnover from all non-casino gaming machines in any 12-month period, less prizes paid in that period.

Funds for authorised purposes

- 2.13 The Act allows operators to raise money for authorised purposes only. These are defined as gambling for any of:
- a charitable purpose;
 - a non-commercial purpose that benefits the whole or a section of the community; and
 - the promoting, controlling, and conducting of race meetings under the Racing Act 2003, including the payment of stakes.
- 2.14 The Gambling (Class 4 Net Proceeds) Regulations 2004 impose conditions on how operators can distribute funds to authorised purposes. These regulations also require operators who distribute funds to distribute a minimum of 37.12% of GST-exclusive gross proceeds to authorised purposes.

Gambling Commission

- 2.15 The Act established the Gambling Commission. The Commission is a Commission of Inquiry but operates as an appeals body run along judicial lines. Operators are able to appeal to the Commission against the Department's decisions.
- 2.16 Under section 81 of the Act, the public are entitled to complain to the Department about the conduct of class 4 gambling. If the public are unhappy with the way the Department has handled a complaint, they are entitled to complain to the Commission. At the time of our audit, there had been no complaints specifically about the Department to the Commission from the public.
- 2.17 As at 19 December 2006, the Commission had published 11 decisions relating to non-casino gaming machines. Of these decisions, the Commission upheld four appeals, partially upheld and partially declined one appeal, declined three substantive appeals and two other appeals, and referred one appeal back to the Department. The Gambling Commission publishes its decisions on its website, www.gamblingcom.govt.nz.

- 2.18 The Commission is independent of the Department. It considers each case afresh as if no prior judgements had been reached on the facts. The Commission's meetings are generally held in private. The Commission is funded through the Department, and the Commission's staff are the Department's employees, although they work independently of the Department. The Commission is based in Auckland, and is physically separate from the Department's Auckland office.

Our consideration of the Department's controls

- 2.19 We discuss the Department's implementation of controls on operators' and venues' entry to, and continued operation in, the industry (through licensing) in Part 3. Monitoring and enforcement of compliance relating to operators' and venues' costs is the subject of Part 4. We discuss the implementation of controls on how and what community purposes operators use gaming machine money for (through grants) in Part 5.

Part 3

Licensing non-casino gaming machine operators and venues

- 3.1 The Department controls operators' and venues' entry to, and continued operation in, the industry through licensing.
- 3.2 In this Part, we discuss how effectively the Department licenses non-casino gaming machine operators and venues.

Our expectations

- 3.3 We expected the Department's licensing policies and procedures to:
- be consistent with the relevant requirements of the Act;
 - be followed by the Department; and
 - be periodically reviewed and updated.
- 3.4 We also expected the Department to have:
- a robust information system that recorded licensing information and made it available to all who needed it, and that contained current information;
 - a transparent, justifiable fees regime that was periodically reviewed; and
 - training and documentation that ensure that staff could competently discharge their functions and have access to adequate resources to carry out those functions.

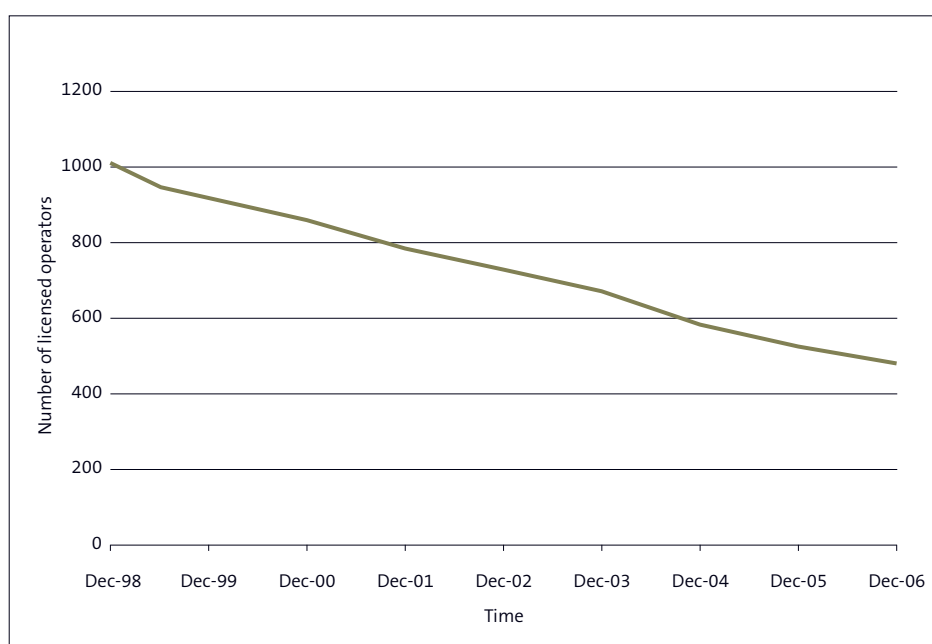
Our findings

- 3.5 As at 30 June 2006, there were 496 licensed operators. Of these, 73 were societies (who generally distribute funds to the community) and 423 were clubs (who generally apply funds to their own authorised purposes). The number of licensed operators has fallen by about half since our report in 1998. The trend in the number of licensed operators is shown in Figure 4.

Information used

- 3.6 The Act requires the Secretary for Internal Affairs (the Secretary) to be satisfied that a number of requirements are met before granting a licence. The Department uses information provided by applicants and other information it gathers to make licensing decisions.
- 3.7 As part of licensing and re-licensing of operators, the Department's accountants assess applicants' financial viability using financial information provided by the applicants. Some of this information may be prepared by the applicants' accountants. We observed some inconsistency in the way expenses were categorised in the financial information provided by operators to the Department. This may limit the Department's ability to compare expenses between operators, other than total expenditure.

Figure 4
Number of licensed class 4 gambling operators 1998-2006



- 3.8 For new applications or when key persons change, the Department's licensing manual requires key person assessments¹ using information from the Police, the Companies Office, and credit checks. We saw examples of these checks. The Department has identified some changes to the Act that would, if enacted, enhance the Department's ability to control the participation of key persons in the industry.
- 3.9 We saw evidence that the staff involved in issuing licences do check with compliance staff (those involved in auditing operators and in relationship management with operators) for relevant information that could influence whether a licence was issued.
- 3.10 We were told, by several of the Department's staff, that licensing information and the results of previous audits were not always available within the Department's information system (Licence Track). We confirmed this to be the case for an operator where compliance information should have been available in the

1 We note that elected members of Licensing Trusts are not key persons for the purposes of the Act. This allows members of licensing trusts to be involved in operating venues but still distribute funds. The Act generally imposes a strict separation between those who run premises at which gaming machines are operated and those who control the proceeds from gaming machines at those venues. However, Parliament considered the potential for conflicts of interest is considerably lower in the case of licensing trust members who are elected under the Sale of Liquor Act 1989, because they are publicly accountable to their local community and are not permitted to benefit personally from the licensing trust.

information system given that the Department had taken legal proceedings and had major compliance concerns with the operator.

Recommendation 1

We recommend that the Department of Internal Affairs ensure that complete licensing and audit information is available in its information system (Licence Track), and that staff check this information during licensing and relicensing of non-casino gaming machine operators and venues.

Partially compliant policies, procedures, and practices

- 3.11 The Department's staff who fulfil the licensing function were formerly known as Gaming Licensing Officers, but are now known as Gambling Inspectors - Licensing. Gambling inspector, however, is a role defined in the Act, with certain specified functions. We believe it is confusing, and potentially misleading, to give licensing staff the title of Gambling Inspector when they are not carrying out the functions of a gambling inspector as defined in the Act.
- 3.12 At the time of the fieldwork for our audit, licensing staff did not have the delegated authority to grant venue licences or renew venue licences, and there was some doubt whether they could renew operator's licences. However, licenses issued by the Department had been issued by licensing staff. We raised this issue with the Department. At the time of writing this report, the Department was reviewing and revising its delegations schedule to ensure that gambling inspectors have delegated authority to grant and renew venue and operator's licences. The Department also took steps to retrospectively validate licences previously issued by gambling inspectors without delegated authority. It obtained a Crown Law opinion that supported its approach to retrospective validation of licences. We consider the Department treated the delegations issue as serious, sought appropriate legal advice, and is acting on that advice.
- 3.13 The Department has a comprehensive licensing manual that outlines its policies and procedures. The licensing manual was completed in November 2004, and was last updated in February 2005. The manual also contains a licensing coversheet for financial viability assessments of operators, a Renewal Job Aid Sheet, and a Renewal Process Coversheet.
- 3.14 When renewing licences or issuing new licences where the prospective key person has been approved for an existing licence, the Department relies on historical information received when the initial licence application was made for aspects of key person checks.

- 3.15 The Department also relies on self-disclosure for some requirements where there is a statutory obligation on licence holders to notify any change in circumstances (for example, a change in the key persons). However, the Act does not require applicants to notify the Department of changes in all of the requirements the Secretary must be satisfied of before renewing a licence.
- 3.16 In our view, relying on historical information and self-disclosure (particularly without any assessment of the rate of non-notification) does not discharge the Department's obligations under the Act.
- 3.17 The risks associated with the Department's approach include:
- not having all the information necessary for the Secretary to discharge their statutory obligation not to issue or renew a licence unless satisfied all the requirements are met;
 - the potential for a key person to remain a key person when they are no longer suitable; and
 - the potential for a key person who is no longer suitable becoming a key person for a new operator or venue.
- 3.18 The specific requirements the Secretary must be satisfied about under section 52 of the Act before renewing an operator's licence are –
- (1) *The Secretary must refuse to grant a class 4 operator's licence unless the Secretary is satisfied that, –*
 - (a) *the gambling to which the application relates is class 4 gambling; and*
 - (b) *the applicant's purpose in conducting class 4 gambling is to raise money for authorised purposes; and*
 - (c) *the applicant's proposed gambling operation is financially viable; and*
 - (d) *the applicant will maximise the net proceeds from the class 4 gambling and minimise the operating costs of that gambling; and*
 - (e) *the net proceeds from the class 4 gambling will be applied to or distributed for authorised purposes; and*
 - (f) *the applicant is able to comply with applicable regulatory requirements; and*
 - (g) *the applicant will minimise the risks of problem gambling; and*
 - (h) *any investigations carried out by the Secretary do not cause the Secretary not to be satisfied about the suitability of the applicant or any key person, in terms of subsection (4); and*

- (i) *there are no factors that are likely to detract from achieving the purpose of this Act; and*
 - (j) *a key person is not a key person in relation to a class 4 venue licence held, or applied for, by the applicant (except in the case of a club that intends to operate gambling equipment on its own non-commercial premises, the New Zealand Racing Board, or a racing club).*
- (2) *In assessing financial viability under subsection (1)(c), the Secretary must consider, among other things, the ability of the applicant to reward winners and pay levies, taxes, and other costs, as well as apply or distribute the net proceeds from the class 4 gambling to or for authorised purposes.*
- (3) *The Secretary may refuse to grant a class 4 operator's licence if an applicant fails to provide the information requested by the Secretary in accordance with section 51.*
- (4) *In determining whether an applicant is suitable for a class 4 operator's licence, the Secretary may investigate and take into account the following things:*
 - (a) *whether the applicant or a key person has, within the last 10 years,—*
 - (i) *been convicted of a relevant offence [required to be notified to the Department under section 54 of the Act]:*
 - (ii) *held, or been a key person in relation to a class 3 or class 4 operator's licence, a class 4 venue licence, a casino licence, or a licensed promoter's licence under this Act or any licence under previous gaming Acts that has been cancelled, suspended, or for which an application for renewal has been refused:*
 - (iii) *been placed in receivership, gone into liquidation, or been adjudged bankrupt [required to be notified to the Department under section 54 of the Act]; and*
 - (b) *the financial position of the applicant and the credit history of the applicant and each key person; and*
 - (c) *the profile of past compliance by the applicant and each key person with—*
 - (i) *this Act, minimum standards, game rules, Gazette notices, and licence conditions; and*
 - (ii) *the Racing Act 2003 or the Racing Act 1971 (and any rules of racing made under either of those Acts); and*

(iii) *previous gaming Acts, and regulations made under previous gaming Acts; and*

(iv) *a licence or a site approval issued under a previous gaming Act.*

3.19 Before renewing a venue licence, the specific requirements the Secretary must be satisfied of under section 67 of the Act are –

(1) *The Secretary must refuse to grant a class 4 venue licence unless the Secretary is satisfied that, –*

(a) *the applicant holds a class 4 operator's licence; and*

(b) *the possibility of persons under 18 years old gaining access to class 4 gambling at the class 4 venue is minimal; and*

(c) *the venue manager is an individual and any investigations carried out by the Secretary do not cause the Secretary not to be satisfied about his or her suitability, in terms of section 68, to supervise –*

(i) *the conduct of class 4 gambling at the venue; and*

(ii) *venue personnel; and*

(d) *any investigations earned out by the Secretary do not cause the Secretary not to be satisfied about the suitability of any other key person, in terms of section 68; and*

(e) *if the application relates to a class 4 venue that is licensed to another corporate society, the other corporate society has surrendered its class 4 venue licence for the venue; and*

(f) *the territorial authority has provided a consent (if required under section 98); and*

(g) *on issue of the licence, the applicant will own any gambling equipment (except for electronic monitoring systems) that it proposes to operate; and*

(h) *on issue of the licence, the applicant will not operate any gambling equipment that is financed by the manufacturer, distributor, or vendor of the equipment; and*

(i) *all gambling equipment to be operated at the venue meets relevant minimum standards; and*

(j) *the class 4 venue agreement (if required) –*

- (i) enables the class 4 gambling conducted at the class 4 venue to comply with this Act and the proposed class 4 venue licence; and
 - (ii) includes the information specified in section 69; and
- (k) the class 4 venue is not used mainly for operating gaming machines; and
- (l) for a class 4 venue that is not established before the commencement of this section, the class 4 venue is not to be part of a place at which another class 4 venue or a casino is located; and
- (m) for an application to which section 65(3) applies, no person will be both a key person in relation to the relevant class 4 operator's licence and a key person in relation to the class 4 venue licence; and
- (n) if the New Zealand Racing Board is the applicant, the class 4 venue is either—
 - (i) owned or leased by the New Zealand Racing Board and used mainly for racing betting or sports betting; or
 - (ii) a racecourse; and
- (o) if the applicant is a racing club, the class 4 venue is a racecourse; and
- (p) the risk of problem gambling at the class 4 venue is minimised; and
- (q) the proposed venue is suitable in all other respects to be a class 4 venue; and
- (r) there are no other factors that are likely to detract from achieving the purpose of this Act; and
- (s) any other requirement set out in regulations or licence conditions is, or will be, met.

3.20 Under its current process, the Department cannot be satisfied all these statutory requirements are met before it renews a licence.

Recommendation 2

We recommend that the Department of Internal Affairs review and change its policy and practice for considering non-casino gaming machine licence applications, so the checks are enough for the Secretary for Internal Affairs to discharge their obligations under the Gambling Act 2003 when issuing a new operator's or venue licence or renewing an operator's or venue licence.

Recommendation 3

We recommend that the Department of Internal Affairs review and amend the key person checks it undertakes when considering non-casino gaming machine licence applications, so the checks are enough for the Secretary for Internal Affairs to discharge their obligations under the Gambling Act 2003 when issuing a new licence or renewing a licence.

Recommendation 4

We recommend that the Department of Internal Affairs periodically (for example, annually) review self-disclosure rates against the requirements of sections 54 and 71 of the Gambling Act 2003, and use this information to improve future self-disclosure rates.

- 3.21 We note the licensing manual refers to a process for renewing non-casino gaming machine licences after the first renewal. Although referenced, this subsequent renewal process has not been documented in the manual. Such a process would need to be clearly justified and comply with the Act.
- 3.22 When issuing some licences, the Department has noted that it has not approved or ratified the accuracy or acceptability of any venue-related costs in the operator's venue agreement, but has checked only that total costs do not exceed those in the Venue Payments Gazette Notice. The Department has also noted that the operator's venue agreement may be audited or investigated in future to assess whether the costs are actual, reasonable and necessary. Section 69 of the Act requires the form and content of a venue agreement to be approved by the Secretary before a licence is issued. Checking that venue cost totals do not exceed those in the Gazette Notice may not be enough to satisfy section 69 of the Act, particularly the requirement to check the content of a venue agreement.
- 3.23 We recognise that the actual operation of the venue agreement cannot be assessed at licensing, but the Department should invest time in making sure that at least the form and content of the venue agreement is satisfactory before issuing a licence, as the Act requires. This could involve assessing whether proposed venue payments are necessary and reasonable. In our view, the Department should not rely solely on a possible future audit or investigation to scrutinise whether the costs in the venue agreement are acceptable.
- 3.24 The Department asks applicants to state how they will maximise net proceeds to discharge the Secretary's statutory obligation under the Act to issue a licence only when satisfied that the applicant will maximise net proceeds. Examples of statements that satisfied the Secretary include –

All proceeds for the improvement and benefit of Club members.

By maintaining a close economic approach to assist in decreasing expenses and therefore increasing the amount of money available that can be allocated to authorised purposes.

- 3.25 The Department checks that expenses meet the requirements in the Gazette Notice relating to venue payments, which assists it to assess whether applicants' costs are below a maximum level. However, the statements about how proceeds will be maximised are important, and should be required to be robust and meaningful.

Recommendation 5

We recommend that the Department of Internal Affairs strengthen its processes for ensuring that the Secretary for Internal Affairs is satisfied that non-casino gaming machine licence applicants will maximise net proceeds.

- 3.26 The Department's licensing fees form was confusing. We saw examples of applicants having over-paid or under-paid their licensing fees as a result. We suggest the Department re-design its licensing fees form to make it clearer.

Administrative inconsistencies

- 3.27 There were some minor administrative inconsistencies between the Department's practice and its policies and procedures in the sample of licence applications and licence renewal applications that we reviewed. These included:
- a failure to limit mortgage payments for clubs to only non-bar facilities in the statement of authorised purpose within a licence (at least ten examples); and
 - the lack of a termination date for a loan in the statement of authorised purposes within a licence (at least four examples).
- 3.28 While not large in funding terms, all of these examples have the potential to enable licence holders to use funds for purposes that were not intended under the Department's authorised purpose policy.
- 3.29 We also noted frequent spelling and grammatical errors in statements of authorised purposes in licences issued. In at least one case, these errors had the potential to make the statement ambiguous. Again, while not large issues, ambiguities have the potential to enable licence holders to use funds for purposes that may not have been intended. The existence of spelling and grammatical errors also indicates a potential lack of care and attention to detail by the Department when issuing licences. We are aware of the pressures faced by

the licensing section that are documented elsewhere in this report. However, given these results, in our view the Department needs to improve its process for reviewing licences before finalising and issuing them.

- 3.30 The Department has a process for peer reviewing recommendations to refuse an application or to cancel a licence. However, there is also a risk of wrongly approving applications, which means approved applications need to be checked to ensure that they are consistent and comply with the Act.

Recommendation 6

We recommend that the Department of Internal Affairs introduce a quality review of non-casino gaming machine operator's and venue licences before the licences are finalised and issued.

- 3.31 The Department has made changes to its licensing process to stagger licence renewals over the year to allow a more even workflow. Previously, all licences were due for renewal at about the same time.
- 3.32 The Department's licensing staff are required to adhere to the Department's code of conduct. Our later comments (see paragraphs 4.78-4.79) about conflicts of interest and independence also apply to the Department's licensing staff.

Timing issues

- 3.33 Operators can continue to operate with an existing licence, while not meeting the requirements to have their licences renewed, provided they have at least submitted an application for renewal by the required date. We were told of two examples where operators continued to operate indefinitely despite returning less than the minimum returns to authorised purposes for two years or more.
- 3.34 In some instances, the Department has not allowed operators or venues to continue operating and has cancelled or suspended licences. We saw an example of the Department cancelling a licence because an operator failed to return enough money to the community. We also saw examples of the Department cancelling a licence and suspending venue licences because of a lack of territorial authority consents for the venue sites.
- 3.35 There have been significant delays in finalising annual licences for some societies and clubs. As at 8 August 2006, out of about 500 licence applications received each year, there were:
- 22 applications for operator's licences from 2004/05 that had not been finally dealt with;

- 3 applications for operator's licences from 2005/06 that had not been finally dealt with; and
- 19 other licence applications from 2005/06 from clubs that had not been finally dealt with.

3.36 We were told reasons for the delays include two of the licensing section's staff being diverted to the EMS project, limited availability of specialist financial resource to the licensing team, and the team operating below its nominated number of full-time equivalents.

Recommendation 7

We recommend that the Department of Internal Affairs give priority to resolving non-casino gaming machine operator's licence applications that have been outstanding for more than one calendar year.

3.37 We note that the Department's 2006-09 Statement of Intent includes performance measures on the timeliness of processing licence applications. Eighty percent of licence renewal applications are to be processed within two months. Ninety percent of all other licence applications are to be processed within one month. These are new measures.

3.38 From 1 September 2006, the Department planned to use a new process for assessing the financial viability of operators during the licensing process. This involved using accountants based in its regional offices. To speed up the processing of completed applications, the Department has also begun to return incomplete licence renewal applications to applicants without processing any of the application. It is also moving towards not delaying the issuing of licences because of audits in progress.

3.39 While not identified by the Department as a delaying factor, all licence applications received by the Department are paper-based. This means the applications have to be manually entered by the Department into its systems. Many of the industry representatives we spoke with indicated a desire for an electronic application process. This could also reduce the amount of data entry the Department is required to undertake.

Monitoring and updating

3.40 The Department has a systematic change control process for amending licensing policies and procedures as a result of the interpretation and application of legislation in the Gambling Commission's decisions.

Stakeholder views

- 3.41 The Department has surveyed internal and external stakeholder views of its licensing section. Stakeholders perceived that the section had been through a lot of change, was hard working, and was generally helpful and professional. However, some stakeholders had had negative experiences with variability of the section's practices and timing of the issuing of licences.

Fees

- 3.42 In 1998 we identified issues with the Department using gambling licence fees for activities not related to gambling. Since that time the Department has reviewed its fees regime. Fees (reviewed every few years) and the model used to allocate corporate overheads within the Department across different business units are now subject to Cabinet approval.
- 3.43 The allocation of corporate overheads is important because it affects the fees charged for licensing non-casino gaming machine operators and venues.
- 3.44 Fees to cover regulatory activities and overheads are set by Order in Council and are therefore subject to Cabinet approval. There is also an annual review of actual overhead costs. The Department told us that it aims to have fees equal its costs, averaged over a period of time (currently five years).
- 3.45 The Department uses a "memorandum account" to track the balance between the income it receives from non-casino gaming machine licence fees and the costs of gaming machine compliance and administration activities undertaken by the Department over the nominated period of time. The Administration of Non-casino Gambling Memorandum Account was established on 30 June 2002, since our previous audit. The balance of this account is reported in the Department's annual report. As at 30 June 2006, the account was nearly \$5 million in deficit. This indicates that expenditure on non-casino gaming machine compliance and administration activities has been greater than the licence fees received since 30 June 2002. The Department has noted that it expects the balance to become zero over time.

Part 4

Monitoring and enforcing compliance

- 4.1 Maximising the funds available for authorised purposes depends on the costs incurred by operators and venues being minimised.
- 4.2 In this Part we discuss our findings on how effectively the Department monitors and enforces compliance with the requirements in the Act, particularly those relating to operator and venue costs. In particular we:
- describe the compliance approach taken by the Department; and
 - assess the Department's approach against our expectations of good practice.
- 4.3 The main tools used by the Department to control operating and venue costs are audits, investigations, and education. We did not examine investigations as part of our audit. This is because a policy and procedure manual for investigations was being prepared by the Department at the time of our audit.

Our expectations

Risk-based approach

- 4.4 We expected the Department's monitoring and enforcement of compliance to be consistent with good practice for regulatory compliance activities. We adopted the same high-level expectations adopted by the United Kingdom's National Audit Office (NAO) for the United Kingdom Gaming Board.¹
- 4.5 The NAO identified that, to give effect to the principles of good regulation, the United Kingdom Gaming Board would need to:
- have an appeals process;
 - target its inspections to known problems;
 - tailor its routine inspections of individual operators to reflect the extent and quality of their self-regulation; and
 - introduce a range of sanctions that could be applied according to the seriousness of the offence.
- 4.6 These expectations can generally be described as a risk-based approach. We expected the Department to take a risk-based approach that covers the specific elements outlined in paragraph 4.5.

Effective policies and procedures

- 4.7 We expected the Department's policies and procedures to:
- be documented and available to interested parties;
 - be consistent with relevant requirements in the Act;

¹ Report by the Comptroller and Auditor-General (2000), *The Gaming Board: Better Regulation*, London: The Stationery Office.

- be followed by the Department consistently across different locations (because this is crucial to the integrity of the regulatory process); and
- be periodically reviewed and updated.

Training and resourcing

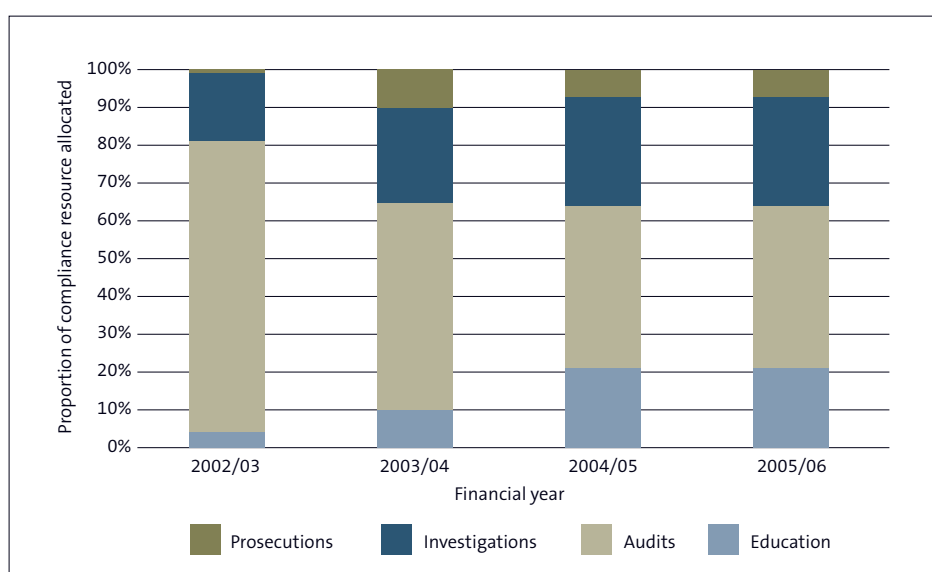
- 4.8 We expected the Department to have training and documentation in place to ensure that compliance staff can competently discharge their functions and have access to adequate resources to carry out those functions.

Our findings

Emerging voluntary compliance approach

- 4.9 The Department believes that enforcement activities should primarily encourage compliance and that the best results will happen when voluntary compliance with the law is high. At the time of our audit, the Department planned to develop a framework describing voluntary compliance in the context of the Department's responsibilities. Both we and the Department believe that, to be effective, voluntary compliance must be complemented by effective enforcement when breaches of the law have occurred.
- 4.10 A changing mix of time budgeted for various compliance activities reflects the Department's move towards a voluntary compliance approach. The Department is budgeting less time for auditing and more time for education and investigation activities. This is shown in Figure 5. The information shown is for all of the Department's compliance activities relating to non-casino gaming machines, not just those relating to operator and venue costs. As staff do not complete time sheets and the Department does not record actual allocation of staff time, we could not confirm if its intentions were reflected in practice. Information provided by the Department indicates that it undertook more investigations, presentations, and visits during the period it reduced the number of audits it carried out.
- 4.11 Until the Department has more information available on the level of compliance within the industry, it is not possible for us or the Department to make a quantitative assessment of whether the Department's emerging voluntary compliance approach is producing greater compliance. The Department says that this approach is producing benefits, but it was unable to demonstrate this quantitatively at the time of our audit.

Figure 5
Budgeted allocation of time resource by compliance tool 2002/03 to 2005/06



Inadequate outcome measurement

- 4.12 In our view, the Department does not systematically and on an ongoing basis monitor the level of compliance within the industry. In the Department's view, its risk-profiling activities, described later in this Part, are used on an ongoing basis to monitor the level of compliance within the industry.
- 4.13 We acknowledge that there is no simple measure of overall compliance. Therefore, determining compliance rates may involve estimates that use a variety of indicative information sources – for example, information on actual returns to the community obtained from operators' audited accounts.
- 4.14 At the time of our audit, assembling information on compliance relied heavily on staff members' awareness of information, their willingness to check multiple systems, their willingness to follow up indications that information exists in another system, and manual communication processes such as telephone and e-mail. The Department has a long-term objective of developing an interface between its licensing and intelligence databases.
- 4.15 The Department is charged with administering the Act. The purposes of the Act that we looked at include maximising returns to the community, and limiting opportunities for crime and dishonesty. The Department does not have outcome measures for these purposes despite the primary role of gambling inspectors being to ensure compliance with the Act. The Department has identified the aim of its regulatory strategy is to increase returns to the community.

- 4.16 A measure of operator compliance that the Department could use, given the information it routinely has available, is the overall level of funds being returned to authorised purposes as a percentage of gross proceeds.
- 4.17 We acknowledge that measuring returns to authorised purposes requires care. This is because the Department has identified three different ways in which societies calculate returns to authorised purposes. The level of returns to authorised purposes can potentially be manipulated by changing depreciation assumptions, as well as changing over time due to legitimate variations in expenses.
- 4.18 Existing performance measures do not provide adequate information about the level of compliance resulting from the Department's activities. For example, the 2006-09 Statement of Intent measures compliance by assessing whether "the percentage of respondents to a survey ... who rate their satisfaction with how information services provided by the Department support their ability to comply with relevant laws, conditions and rules is no less than 85%". The Department acknowledges that this measure is not directly related to compliance but rather gives an indirect indication of compliance. The value of this measure is further limited by the response rate to the survey, which was just over 50%.
- 4.19 The Department has committed, in its 2006-09 Statement of Intent, to developing outcome measures over the next 3-5 years. It also stated in October 2002 that it intended to "develop a strong organisational output and outcome measurement system". In our view, the Department should accelerate this work, given its importance in demonstrating to stakeholders the results being achieved by the Department and for informing the Department's understanding of the effect of its work. This includes demonstrating the results of its emerging voluntary compliance approach to stakeholders and staff.

Recommendation 8

We recommend that the Department of Internal Affairs accelerate work on outcome measures relating to compliance within the non-casino gaming machine industry.

Risk-based approach in place

- 4.20 Although the Department's strategic approach to compliance is still emerging, the fundamental elements we expected the Department to have were in place. However, there were also significant improvements that could be made to a number of these elements, particularly on consistency of practice and compliance with the Act. The findings against each of our specific expectations are outlined below.

Appeals process in place

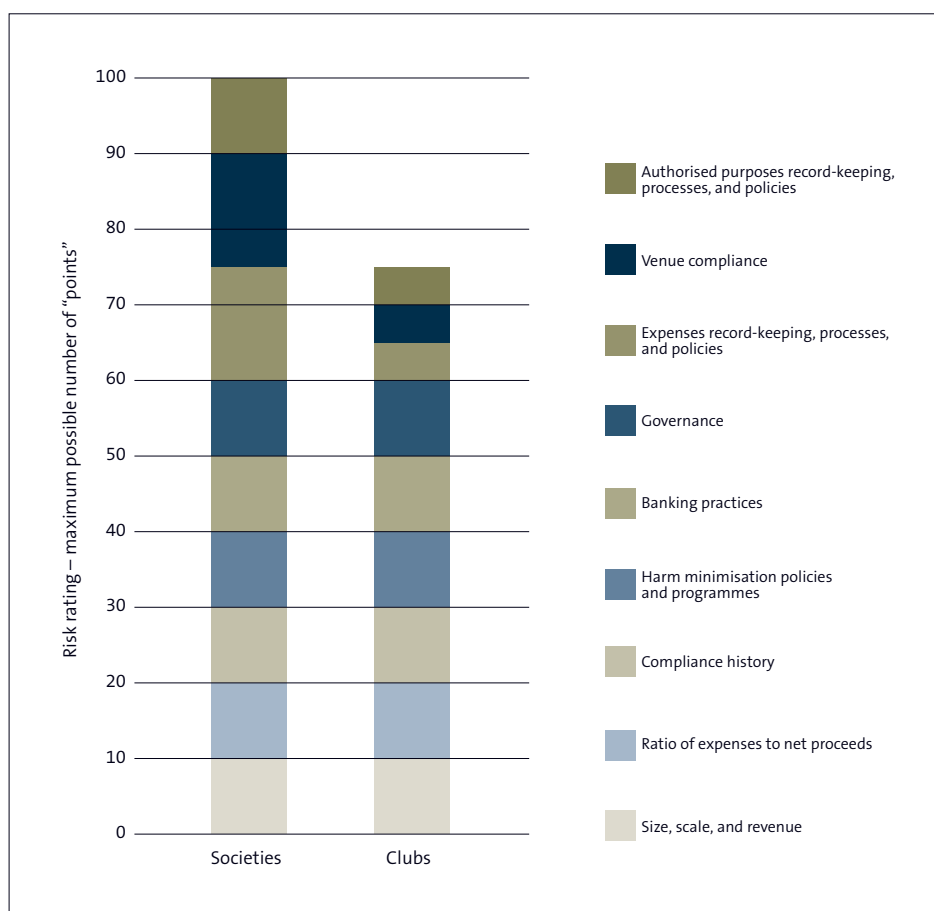
- 4.21 Operators are able to appeal the Department's decisions to the Commission. Appeals are managed on behalf of the Department by its Operational Policy and Legal Services sections. The Commission is independent of the Department. See Part 2 for more information about the Commission.
- 4.22 Under section 81 of the Act, the public are entitled to complain to the Department about the conduct of non-casino gaming machine operators and venues. The Department told us that it investigates all complaints, as the Act requires. If the public are unhappy with the way the Department has handled a complaint they are entitled to complain about the Department to the Commission. At the time of our audit, there had been no complaints specifically about the Department to the Commission.

Risk-based targeting

Risk profiling

- 4.23 The Department uses risk profiling to assess the level of risk it believes an operator poses relative to other operators. Risk profiling was introduced in the 2003/04 year. Risk profiling involves assessing the level of risk of each operator against nine different risk factors and rating this on a categorical scale for each factor. The points from each risk factor are added up to determine the total risk. This is known as an operator's risk profile.
- 4.24 The weightings used for societies (who generally distribute funds) are different from those used for clubs (who generally apply funds) for three of the factors (as shown in Figure 6). Clubs score out of a maximum of 75, while societies score out of a maximum of 100. This is because the Department has decided that the generally smaller number of gaming machines in clubs, and their generally less complex organisational and operating arrangements, make them lower risk. There is also a view among some Department staff that clubs will be self-regulating because any diversion of funds affects the clubs directly.
- 4.25 The factors and the relative weightings given to each factor are shown in Figure 6.
- 4.26 The approach used by the Department enables a gambling inspector or manager to make a change to the overall risk assessment for a given operator. However, a lack of guidance on how to change overall risk profiles, lack of controls over those with the ability to make changes, and the significant gaps in information about operators (as described later in this Part) present a risk to the Department's reliance on risk profiling to determine its work programme.

Figure 6
Factors and weightings used for risk profiling societies and clubs



Recommendation 9

We recommend that the Department of Internal Affairs improve its controls over gambling inspector or manager adjustment of a non-casino gaming machine operator’s overall risk profile rating.

Differential scoring of clubs and societies

- 4.27 In our view, the Department has made a judgement on the relative risks of societies and clubs without definitive information on differences in their actual levels of compliance.
- 4.28 We recognise that clubs generally have lower turnover and have some incentives to maximise their returns, such as the fact that proceeds are indirectly returned

to club members through club facilities and services. However, the Department's staff we talked to pointed out that clubs typically had other risks. These included a relatively high turnover of staff, and reliance on volunteers who may have limited knowledge of their non-casino gaming machine obligations. One of the Department's senior staff expressed the view that fraud or theft meant that clubs were stealing only from themselves, so the matter was for the police to investigate rather than the Department. This approach appears at odds with one of the purposes of the Act, which is to limit opportunities for crime and dishonesty, and the Department has made achieving this purpose a priority.

- 4.29 In our view, the Department could do more to recognise and use appropriate interventions to address the particular risks that clubs present. This is reflected in the Department's acknowledgement that its risk assessment may not match its intelligence information for selected organisations. This may include some societies as well as clubs.
- 4.30 A mismatch between assessed and actual risks is a known issue with semi-quantitative risk analysis approaches such as that used by the Department. The Australian/New Zealand Risk Management standard² recognises that a semi-quantitative approach "may not differentiate properly between risks, particularly when either consequences or likelihood of [those risks] are extreme".

Missing information

- 4.31 Where the Department is missing current information for a given risk factor, it makes assumptions about the level of risk for an operator. We noted some inconsistencies in these assumptions in practice. We attended the moderation meeting where the national audit work programme for 2006/07 was set, and observed that various staff had different views on how to rate a risk factor when no information had been collected. Some staff suggested the risk factor should be rated high, while others said a medium or low rating should be given.
- 4.32 The Department's 2005 risk-profiling documentation states "the fact that a club has not been visited for a period of time should not necessarily infer that the venue compliance criteria should be rated as a high score [high risk of non-compliance]. Unless there is evidence to the contrary then the rating should be at the low end of the scale [low risk of non-compliance]." We disagree with this direction. In our view, good practice is to increase a risk rating over time in the absence of information. At least one of the Department's staff members has suggested "time since last audit" be included in the risk assessment criteria for clubs.
- 4.33 The lack of information about operators is a significant problem for the Department. While the Department's risk-profiling documentation suggests

² AS/NZS 4360: Risk Management (2004).

risk profiles will be continually updated based on complaints, licensing, audits, investigations, education visits, and other activity, we observed that the Department had little or no information on many operators available at its moderation meeting. For example, at the national moderation meeting we attended, only two out of about 94 clubs in one region had the risk-profile fields populated.

Recommendation 10

We recommend that the Department of Internal Affairs reduce the level of missing information about non-casino gaming machine operators within its risk-profiling system, and improve the consistency of assumptions about operator risk in the absence of current information about operators.

- 4.34 As noted above in relation to licensing, information about compliance history and licensing information was sometimes not entered in the Department's Licence Track system. Some staff told us it was very difficult to locate even the previous year's audit report for an entity, and that they had to retrieve the physical file for the operator or venue to get this information.

National audit work programme

- 4.35 Risk profiles are used to determine the "frequency, timing, focus and type of compliance activity undertaken" within the constraints of the available resources. The profiles are ranked and then the greatest compliance resource is allocated to the operators with the highest risks. In practice this means that operators with a risk profile above a high-risk level are included on a national audit work programme. One result of this scoring system is that few clubs get included in the national audit work programme. For example, in 2006/07 the Department proposed about three clubs out of 423 for inclusion in the national audit work programme. The Department undertook 357 audits of clubs in 2002/03. This reduced to 14 audits in 2005/06.
- 4.36 In our view, setting the level for inclusion in the national audit work programme is a flexible process. We observed that the definition of high risk changed from year to year. Over time, it is therefore possible for the Department to vary the level of risk that determines whether an operator is included in the national audit work programme.
- 4.37 Audits cannot be added or removed from the national audit work programme during a year without the agreement of the management team. Some staff complained that this system was inflexible. Investigations can be conducted during the year if prompted by a complaint or similar trigger, but are not classed as an audit.

- 4.38 The focus on high-risk operators, with no random audit of other operators, is the same situation we found in our 1998 review, although the Department was auditing 50% of all operators in some of the intervening period.
- 4.39 The Department has recognised it does not have a long-term strategy to ensure compliance of those operators not included in its national audit work programme.
- 4.40 While the Department has indicated that it uses the results of risk-profiling to inform its non-audit work programme, the Department has no procedural guidance on how this should happen.

Recommendation 11

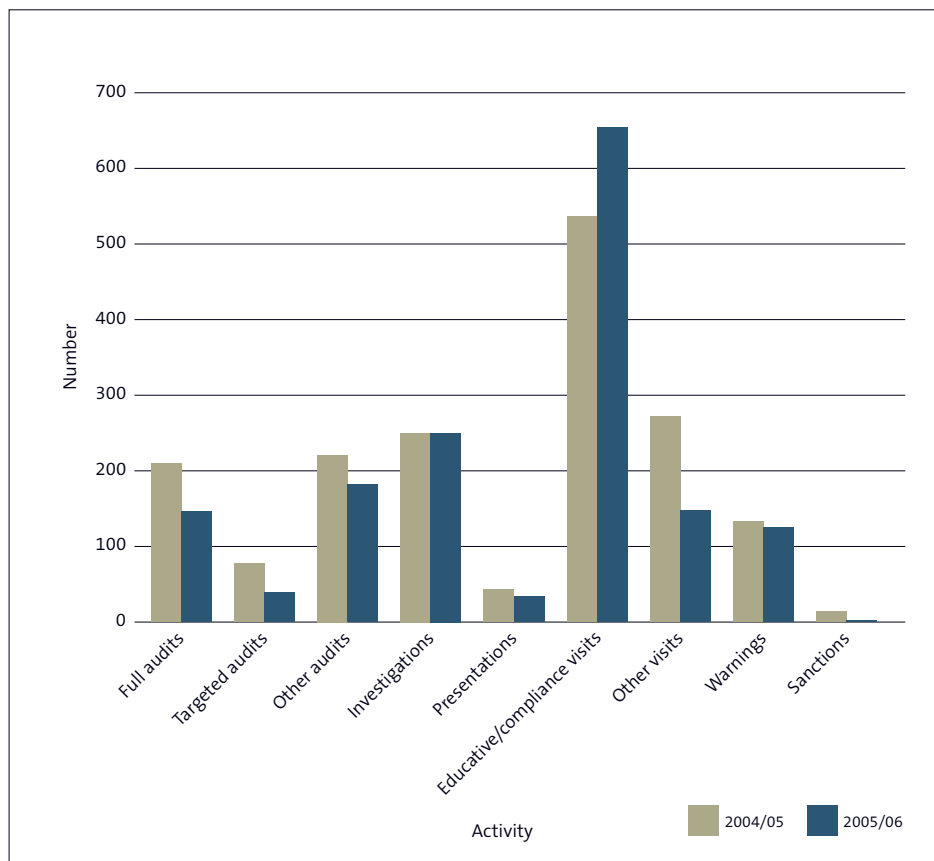
We recommend that the Department of Internal Affairs improve information in its planning and accountability documents by stating the quantity of work the Department will undertake for its chosen audit risk threshold for operators, and indicate the expected contribution of this work to compliance in the non-casino gaming machine industry.

Number of audits

- 4.41 The number of audits included in the national audit work programme has reduced over time. This is because of the Department's approach since the introduction of the Act. In April 2001, Cabinet decided the Department should audit 50% of societies each year. The Department states this was to improve the effectiveness of audits, increase public confidence in the regime, and reduce public criticism over non-compliance. From 2002/03, the requirement was reflected in the Department's Statement of Service Performance.
- 4.42 The Department told us that, in practice, the requirement to audit at least 50% of operators each year resulted in a "tick and flick" approach to audits, with the emphasis on the quantity of audits rather than the quality of an operator's actual compliance. In 2003, Cabinet rescinded its 50% audit requirement, to allow a new risk-based approach to be implemented.
- 4.43 The risk-based approach taken by the Department has resulted in fewer audits being done by the Department than in previous years. In our view, there is a risk that, by doing fewer audits, the Department gathers less information about entities. This means that fewer meet the threshold of "high risk" to warrant an audit, which leads to a further reduction in its audit activities.
- 4.44 The Department has itself recognised that not regularly auditing clubs affects its risk-profiling information. A "compliance education society visit" has been suggested by Department staff as a method of obtaining information to update the risk profile for operators that have not been audited recently.

- 4.45 We attempted to ascertain definitive information on the number of audits, visits and sanctions applied by the Department for each of the years from 2002/03 to 2005/06. We used a variety of sources of information. These included annual reports, responses to Parliamentary Questions, and information provided directly to us by the Department. Because there were some considerable differences between the information sources, we asked the Department to provide us with a definitive set of activity information.
- 4.46 Because the definitive information provided also differed considerably from some of the other activity information the Department had previously supplied to us, we asked the Department to explain why. The Department then undertook an internal review of its activity reporting information. The outcomes of the review were:
- a set of detailed definitions that the Department will use for subsequent activity reporting;
 - the Department providing us with further updated activity information for the 2004/05 and 2005/06 years;
 - the Department indicating that, in relation to activity reporting, it had “instituted a regime of independent quality assurance of the reported figures”; and
 - the Department indicating it had not reviewed data for the 2002/03 and 2003/04 years because that data was collated when the Department was developing its reporting mechanisms and definitions, and was recorded in a database that would require a large investment of staff time to extract information from.
- 4.47 The most recent 2004/05 and 2005/06 information provided by the Department is shown in Figure 7.
- 4.48 While the Department has indicated that it has improved its activity reporting process, we believe that this is an area to which the Department needs to give further attention. Reliable activity reporting information is particularly important if the Department is to understand relative use of resources within its voluntary compliance approach and the outcomes the approach is achieving. We will ask the Appointed Auditor of the Department to give extra attention to the Department’s activity reporting when next auditing the Department.
- 4.49 Because of the considerable differences in reported levels of activity between some of the historical information sources, including between Parliamentary Questions and other sources, we asked the Department whether it was intending to review any historic information already in the public arena. At the time of our audit, the Department told us that it was undertaking further work to validate

Figure 7
Compliance activity reported by the Department 2004/05 and 2005/06



historical activity information and that it would correct any information found to be incorrect. The Department also noted that a lot of change occurred within non-casino gambling during the period covered by the historical information in question.

- 4.50 We believe the Department’s future activity reporting should be more reliable as a result of the definitions and assurance processes it has put in place in response to our audit. However, we suggest caution in using historic information about the Department’s non-casino gambling related activities.

Recommendation 12

We recommend that the Department of Internal Affairs continue to closely scrutinise and improve, where necessary, its recording and reporting of the volume of activities that it has undertaken related to non-casino gaming machine operators (such as audits, investigations, and sanctions applied), and corrects any activity information already in the public arena that it determines is incorrect.

Scale and scope of audits

- 4.51 Audits on the national audit work programme can involve checking some items in a checklist (a targeted audit) or all items in a checklist (a full audit). The risk-profile information determines whether a targeted audit or a full audit is undertaken. However, the Department's policies and procedures do not provide guidance on how staff should determine the circumstances in which individual items from the audit checklist should be used in an audit. The Department relies on the judgement of staff using information and knowledge about a given operator, and requires staff to consult with a senior gambling inspector.
- 4.52 The Department's audit manual states that most audits will be targeted. For example, the Southern regional office conducted only one full audit in 2005/06. The Department's audit manual also states that the reason for a targeted audit will be documented and an audit plan prepared. We were told that targeted audits typically take between one week and two months.
- 4.53 Because of the flexibility the Department has over the content of audits, caution must be exercised when examining trends in the number of audits undertaken by the Department over time. Trends in the number of audits are not necessary indicative of the Department's total audit activity.

Reporting on audit activities

- 4.54 A summary of the Department's main compliance activity measures for 2005/06 is provided in Figure 8. The Department has reflected the main compliance activity measures from its statement of service performance³ in its internal business plan. The Department provided us with documentation that showed it tracked the number of different compliance interventions undertaken in each month by each regional office.
- 4.55 Although the Department commits to auditing high-risk operators in its 2006-09 Statement of Intent, high risk is not defined in that document. Until 2005/06, the Statement of Service Performance required some auditing of low-risk societies, but this was no longer required after 2005/06.
- 4.56 The Department excludes some steps in its reporting of the time taken to complete an audit. The audit starts once all requested documentation has been received, and is completed when the draft audit report is sent to the operator. The time taken to begin an audit after notifying the operator and for completing an audit once a draft report has been finished are not included in the Department's reporting of audit timeframes. We recognise that the time to complete an audit will depend in part on the conduct of the operator. However, in our view, these timeframes are largely within the Department's control and should be included

³ Section 45A of the Public Finance Act 1989 requires a statement of service performance to describe each class of outputs supplied by the Department and the standards of delivery performance for each class of outputs.

Figure 8
Main compliance activity performance measures 2005/06

Compliance tool	Main activity performance measures 2005/06	
	Business Plan	Statement of Forecast Service Performance
Audits	Undertake audits of all gaming machine societies identified as high risk, in accordance with their risk profile.	Undertake audits of all gaming machine societies identified as high risk, in accordance with their risk profile.
	All non-compliant practices identified during audit processes or via complaints will be acted upon in accordance with the Enforcement Policy.	All non-compliant practices identified during audit processes, intelligence gathering, or via complaints will be acted upon in accordance with the Enforcement Policy.
	The number of instances of non-compliance with gambling laws that are detected during audits and investigations and not rectified during the follow up process will be no greater than 20%.	
	Undertake audits of other gambling activities identified as high risk.	Undertake audits of other gambling activities identified as high risk.
Investigations	The number of instances of non-compliance with gambling laws that are detected during audits and investigation and not rectified during the follow up process will be no greater than 20%.	Undertake investigations of all gaming machine societies where serious non-compliance is identified through audit, intelligence gathering or complaints.
Education and persuasion	Undertake 200 formal presentations and educative compliance venue visits to the gaming sector by 30 June 2006.	Undertake 200 formal presentations and educative site visits to the gaming sector.

in its reporting. Without including these, the reported time measure is inaccurate and can be misleading.

- 4.57 There is also a wide variety in the size of audits. Some audits of national societies involve multiple venues across New Zealand, while others may involve a society operating from a single venue. The Department needs to differentiate between the size of audits in its reporting.

Recommendation 13

We recommend that the Department of Internal Affairs differentiate between different sizes of audits of non-casino gaming machine operators, include the full time taken for audits in its performance recording, and reflect these in its accountability documents.

Extent and quality of self-regulation

- 4.58 The Department does not tailor its routine inspections of individual operators to reflect the extent and quality of their self-regulation. This was not of major concern to us, given the requirements of the Act, the state of development of the industry, and the Department's emerging voluntary compliance approach. In our view, the Department is improving its relationship and interactions with the industry such that, over time, they may support a more self-regulatory approach, should a policy decision be made to adopt such an approach.

Sanctions

- 4.59 The Department's Enforcement Policy follows the principle that the application of a sanction should relate to the seriousness of the breach identified. There are a range of sanctions available to the Department. Listed from most serious to least serious, these include:
- initiating prosecution action;
 - cancelling or not renewing an operator's licence;
 - suspending an operator's licence;
 - cancelling a venue licence;
 - suspending a venue licence;
 - amending, revoking, or adding conditions to a licence;
 - issuing an infringement notice;
 - requesting an operator to address a problem; and
 - education.
- 4.60 A Sanctions Group gives advice, but does not make decisions, on which sanctions to apply. The intended purpose of the group is to assist consistency of decision-making across the Department's regional offices. The National Manager, Gambling Compliance decides what sanctions to apply.
- 4.61 The Sanctions Group generally meets weekly. There are no minutes from the group's meetings. Therefore, we could not judge the consistency of advice on proposed sanctions it received from gambling inspectors, consistency of the Sanction Group's advice with the Department's policies (primarily its Enforcement Policy), or consistency of the sanctions applied on the advice of the group.

- 4.62 The Act gives the Department the power to issue infringement notices. The Gambling (Infringement Notices) Regulations 2004 were introduced to prescribe the form of any infringement notice that will be issued. At the time of our audit, the Department did not use infringement notices because its information system could not issue them. Infringement notices enable fines to be imposed on operators for certain breaches of the Act. We were told that, because information technology resources were committed to EMS, they were not available to make infringement notice changes to the Department's Licence Track system.
- 4.63 We were told that the Department intended to issue infringement notices using a manual process from 1 July 2006. We were also told that approval to issue an infringement notice would be subject to review by the Sanctions Group and/or approval by the National Manager, Gambling Compliance. In our view, this process reduces the intended benefits of infringement notices, which is that they are able to be immediately issued. However, we recognise the ability to use infringement notices is a fairly significant power that needs to be exercised with discretion.

Policies and procedures

Documentation

- 4.64 Policies and procedures exist for auditing and enforcement activities. The Department has an Enforcement Policy (the policy), an Audit Checklist (the checklist), and an Audit Reference Materials Manual (the manual). The policy provides guidance on what interventions the Department will use and when. The checklist is used by gambling inspectors to guide and record their audit activities. The manual contains detailed policies and procedures on how to conduct an audit. The checklist, policy, and various education materials are freely available on the Department's website.
- 4.65 The manual does not contain analytical guidance for staff on assessing what are reasonable expenses by operators. We recognise that assessing reasonable expenses is not straightforward. However, we believe the Department could do more to provide guidance on this issue. Until it does, this will remain an area where significant benefits to the community could be lost.
- 4.66 The Department has recognised that there are limitations to its procedural guidance on reasonable expenses. It is intending to collect information on aspects of operator costs as part of the society audits conducted in 2006/07, which it has the power to do under the Act. This information may help inform the development of procedural guidance and/or comparative material to help assess reasonable expenses.

- 4.67 Within the industry there is variance in operator management structures and expenses. Some operators contract almost all management and day-to-day running to a management company. Other operators might do all this work themselves. Given that all operators have the same obligation to minimise costs and maximise returns to the community and incur only actual, reasonable and necessary costs, benchmarking of the relative costs of the different management approaches would be useful.
- 4.68 The Department needs to exercise care to not impose additional compliance costs on the industry unless these are justified. It already has a lot of information supplied at licensing time, which it could use for benchmarking. This information could be used to help check and benchmark operators' expenses without imposing significant compliance costs on the industry. This would allow the Department to more accurately assess whether operators are minimising their expenses, and could allow it to share best practice with the industry on how to minimise expenses.

Recommendation 14

We recommend that the Department of Internal Affairs develop guidance on reasonable non-casino gaming machine expenses by making better use of the information it already collects and, where necessary, by gathering more information.

- 4.69 We found a lack of policies or procedures on non-audit interventions, other than educational visits.
- 4.70 The manual contains a venue education visit procedure. We believe the procedure does not provide enough guidance and instruction on how to conduct an educational visit. The educational visit procedure contains the same material as the audit checklist, except that in some places, instead of directly checking systems, the venue education visit checklist suggests asking the venue manager what their system is. The procedure refers to "taking the opportunity to encourage voluntary compliance" but provides no further detail on how to do that, other than providing the extract from the audit checklist. Accordingly, there is not a clear distinction between an educational visit and some audits.
- 4.71 The venue education visit checklist covers a range of issues. Aspects of operation, such as what information needs to be displayed at the venue, are checked as part of an educational visit. However, other more detailed record-keeping requirements are not part of the venue education visit checklist. From the information in the manual, in our view, the educational visit is like a shorter, narrower audit. This is of concern, given the Department's reliance on educational visits as a crucial part of its voluntary compliance strategy.

- 4.72 We also found that the application of warnings following educational visits by gambling inspectors is inconsistent with the intent of those visits and the Department's Audit Reference Materials Venue Education Visit procedure in the manual. This practice could involve gambling inspectors auditing the same organisations they have provided educational assistance to, and there being little difference between an educational visit and some audits.
- 4.73 The Act introduced a requirement that operators who cease operating supply certain information to the Department. The Department has a comprehensive cessation audit process for operators to complete to satisfy this requirement. Previous practice was that societies that were to be audited but ceased operating did not need to be audited, and the audit was not counted. This approach created a risk because operators who ceased operating were not audited to ensure that they had properly accounted for funds once they ceased operating. It is important that cessation audits are carried out for all operators who do not renew their licence when it expires.

Policies and procedures partially compliant

- 4.74 There are some inconsistencies between the checklist, the manual, and the requirements of the Act. The checklist does not fully represent the requirements of the legislation. This also affects the venue education visit procedure, which contains extracts from the checklist. In many instances, the manual does not contain enough information to allow a gambling inspector to fully assess whether the legislative requirements are met. In some places, the checklist contains a higher standard than that required by the legislation. Because of the reliance placed on the checklist, any errors or omissions directly affect compliance. These errors and omissions need to be corrected.

Recommendation 15

We recommend that the Department of Internal Affairs review its non-casino gaming machine Audit Checklist and Audit Reference Materials manual against the specific requirements of the Gambling Act 2003, review the information gambling inspectors need to meaningfully assess compliance with these requirements, and amend the checklist and manual accordingly.

Some inconsistency in practice

- 4.75 We examined some of the Department's files, and found certain differences in the manner in which Department staff implemented policies and procedures when conducting audits. These included differences in the:
- use of case plans for audits (the Department's procedure requires case plans for all audits), completion of the audit checklist, and completion of the audit checklist coversheet;

- way that reasonable expenses were examined, which is to be expected given the lack of analytical guidance available to staff on this issue – it was not clear to us that the Department’s examination of reasonable expenses was on the basis of risk and/or materiality; and
 - time taken to complete audits and various stages of an audit – this variation presents a credibility risk for the Department, given that it often demands information from the industry within fixed and relatively short timeframes.
- 4.76 Some operators also told us that they had experienced inconsistencies in the Department’s application of policies and procedures, although one industry representative told us the Department was working hard to get consistency in audits. While we saw evidence of review of audits and completed audit checklists by senior staff within a regional office, we did not see evidence of review across regional offices.
- 4.77 At the time of our audit, the Department planned additional training for compliance staff in 2006/07 to improve consistency of practice. This included training in:
- writing;
 - financial analysis;
 - use of infringement notices; and
 - investigative practices.

Conflicts of interest and independence

- 4.78 We found no evidence of independence issues being considered during the conduct of audits beyond the Department’s reliance on staff adhering to its code of conduct, including the specific impartiality and conflicts of interest requirements in the code. In our view, these requirements are not sufficiently detailed given the nature of audit work. We did not find problems with independence and conflicts of interest, but some additional practices could provide the Department, its staff, and the industry with more protection from these risks.
- 4.79 Given the importance of independence in conducting compliance activities, the Department could develop a specific policy on independence of compliance staff (including licensing staff), in addition to its code of conduct requirements. Such a policy could, for example, establish a mechanism (such as an interests register) for recording those types of ongoing interests that can commonly cause a conflict of interest and for updating it regularly. It could also provide avenues for training and advice, and provide a mechanism for handling complaints or breaches of the

policy. Such a policy would better protect staff decisions against allegations of bias. Bias means the possibility that the decision-maker might unfairly regard, with favour or disfavour, the case of a party to the issue under consideration. The Department gave us a copy of Guidelines of Expected Behaviours for Gambling Compliance Group Staff that it produced in August 2004, but these guidelines have not yet been finalised or implemented.

Recommendation 16

We recommend that the Department of Internal Affairs enhance its management of compliance staff independence risks so gamblers, the Department of Internal Affairs, its staff, and the non-casino gaming machine industry are better protected from these risks.

Limited review and update

- 4.80 Given the limited time the Act has been in place and the limited compliance outcome monitoring, we did not expect the Department to have extensively reviewed its policies and procedures. We found this to be the case. Some important documentation was finalised and some was still being finalised after our audit. We note that the Department updated the audit checklist for the 2006/07 year.
- 4.81 The Department's audit checklist and manual will need updating when EMS is fully operational.
- 4.82 While the Department has limited quantitative information on its results, it is seeking feedback from some stakeholders about their perceptions of its performance. We understand that this information is being used to inform the Department's ongoing strategic development.
- 4.83 For each of the last three years, the Department has commissioned a survey of the wider gambling sector. One of the purposes of the survey is to assess the perceived effectiveness of the Department's activities. The feedback identified consultation, consistency of training for the sector, and timeliness as perceived issues. The feedback we received from the sector while conducting our audit included positive feedback on the Department's newsletter *Gambits*.
- 4.84 The Department also conducted a "Gaps Analysis" in June 2006 of perceptions and experiences with different sections of its Gambling Compliance Unit. The external view of the unit was that it behaves as an enforcer, and is heavy handed and process driven.

- 4.85 As noted earlier, the Department has a complaints procedure. The information gained from complaints is a potential form of monitoring of the Department's practices.

Training and resourcing

- 4.86 With the exception of the licensing function, the Department's compliance managers we spoke with did not identify resourcing as a barrier to undertaking their compliance functions.
- 4.87 The documentation available on operator and venue costs has been described earlier in this Part. This documentation and a "buddying" arrangement are the main means of training support available to new gambling inspectors. Compliance staff also have access to departmental legal advice for specific queries that arise during compliance work.

Part 5

Compliance of grant processes and payments

- 5.1 Operators use grants to distribute funds to authorised purposes. The processes operators use for making grants vary in sophistication. The type of grants operators make also varies widely reflecting operators' different authorised purposes. Some operators make grants for only a single purpose (for example, local rugby), while others will consider applications from community groups throughout New Zealand for a wide range of activities.
- 5.2 In this Part we discuss our findings on how effectively the Department ensures that operators' grant processes and grant payments comply with the requirements of the Act. In particular we:
- describe the approach taken by the Department; and
 - assess the Department's approach against our expectations.
- 5.3 Audits and investigations are the main means by which the Department monitors grant processes and grant payments.

Our expectations

- 5.4 We expected the Department's grant process and grant payment policies, procedures, and practices to:
- be consistent with relevant requirements of the Act;
 - be followed by the Department; and
 - be periodically reviewed and updated.
- 5.5 We also expected the way the policies and procedures are applied to be informed by intelligence and a risk-based approach.

Our findings

- 5.6 We were told that the Department has limited ability to investigate grant recipients because of a District Court judge's decision. In that case, the judge refused to issue a search warrant in respect of an investigation into a possible dishonesty offence by a grant recipient, where the matter did not form part of an investigation into a licensed operator. The decision has limited the power of the Department when attempting to investigate some acts of grant recipients. The Department has provided legal advice to its regional compliance managers to this effect, but not all gambling inspectors in these offices appeared familiar with this advice.
- 5.7 We believe that, for some people we spoke with, a lack of understanding of the case was influencing their wider understanding of the Department's

responsibilities for grants and non-casino gambling. Comments from some staff indicated that they believed the District Court decision substantially narrowed the Department's responsibilities for grants and non-casino gambling.

Recommendation 17

We recommend that the Department of Internal Affairs provide its staff with clear guidance on the extent of its responsibilities for grants and non-casino gaming.

- 5.8 In 2006, the Department obtained a conviction of the manager of an operator who knowingly offered a grant with a condition attached. Also in 2006, in a different case, the Serious Fraud Office obtained a conviction of a person on charges relating to the handling of money from non-casino gaming machines on the condition of a "kickback".

Policies and procedures partially compliant

- 5.9 At the time of the fieldwork for our audit, policies and procedures for investigations were being prepared.
- 5.10 Grants and grant processes are included in the checklist. However, the checklist does not cover all of the website publication requirements in the Act and the Gambling (Class 4 Net Proceeds) Regulations 2004. These require operators to publish certain information about grants, grant funds, and decision-making criteria within certain timeframes.
- 5.11 While not all of these requirements are included within the checklist, the Department has examined compliance with these requirements. It has published information indicating that it is aware of non-compliance with some of the requirements. We also found non-compliance with website publication requirements in the small sample of operators' sites we checked, which the Department needs to address.

Practice

- 5.12 Grants and granting may be examined as part of a full or targeted audit. Our earlier comment about a lack of policies and procedures also applies here. The decision to look at grants and granting in an audit can depend on the judgement of an individual, which may be inconsistent between individuals for a given set of circumstances.
- 5.13 We were told that large societies typically have more developed and extensive grant monitoring and audit procedures than smaller societies. We were told this is one of the factors the Department's staff take into account when considering risks and therefore the scale and coverage of issues included within an audit.

5.14 We observed examples of the Department having audited grants and grant processing as part of audits. One of these audits examined over 1000 grants.

5.15 Examples of issues found by the Department were:

- grants not fitting an operator's statement of authorised purpose;
- use of funds by recipients for other than stated purposes;
- difference between actual and published grant information; and
- total grants less than the minimum of 37.12% of gross proceeds.

Limited grants monitoring

5.16 Every few years, the Department conducts surveys on the allocation of grants, but does not systematically monitor the level of compliance of grant recipients or operator granting processes, except as part of audits and through complaints and investigations.

5.17 The Department does not have access to the centralised databases of grant recipients and payments operated by some large societies and management companies (who provide contracted management and administrative services to operators). The databases are used by those organisations to identify potential "double-dipping" – that is, recipients attempting to obtain grants from multiple operators for the same product or service. Both the Department and a number of industry representatives told us that they perceived the level of double dipping to be high, but we were not able to verify this with the information we had available.

Intelligence-based audits of grants and granting

5.18 The Department does not regularly and systematically collect information on grant risks, but it does periodically receive intelligence, primarily through complaints, on grant issues. As an example, 20% (11) of the complaints received in one regional office between 1 July 2005 and 31 May 2006 related to grants. The Act requires the Department to investigate all complaints, and the Department told us it does this.

Publications by the Auditor-General

Other publications issued by the Auditor-General recently have been:

- Controlling sensitive expenditure: Guidelines for public entities
- Performance of the contact centre for Work and Income
- Residential rates postponement
- Allocation of the 2002-05 Health Funding Package
- Advertising expenditure incurred by the Parliamentary Service in the three months before the 2005 General Election
- Inland Revenue Department: Performance of taxpayer audit – follow-up audit
- Principles to underpin management by public entities of funding to non-government organisations
- Ministry of Education: Management of the school property portfolio
- Local authority codes of conduct
- Housing New Zealand Corporation: Effectiveness of programmes to buy and lease properties for state housing
- Local government: Results of the 2004-05 audits – B.29[06b]
- Inquiry into certain allegations about Housing New Zealand Corporation
- Department of Conservation: Planning for and managing publicly owned land
- Ministry of Agriculture and Forestry: Managing biosecurity risks associated with high-risk sea containers
- Annual Plan 2006-07 - B.28AP(06)

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Office of the Auditor-General
Private Box 3928, Wellington

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

E-mail: reports@oag.govt.nz
www.oag.govt.nz