

National Indian Gaming Commission
Philip N. Hogen, Chairman
Senate Indian Affairs Committee Hearing
June 28, 2007

Good morning Chairman Dorgan and members of the Committee.

My name is Philip Hogen, and I am a member of the Oglala Sioux Tribe from South Dakota. I have had the privilege of chairing the National Indian Gaming Commission (NIGC) since December of 2002.

Thank you for inviting me to discuss the draft legislation regarding the regulation of Class III gaming. I would like to offer some preliminary thoughts about it, and as you will see, those thoughts are informed by the role NIGC plays in the regulation of Class III gaming and the impact of the *Colorado River Indian Tribes* decision on NIGC's regulation of the Indian gaming industry.

The NIGC strongly supports Section 2 of the bill, which clarifies NIGC's regulatory authority over Class III gaming. In addition, NIGC has some concerns about Section 3 of the bill, which sets up a new mechanism for the regulation of Class III gaming. I must emphasize that those concerns are preliminary as the Commission is still reviewing and analyzing the draft. We stand ready to work with the Committee and the Committee staff to further review this concept and to best produce an effective structure to insure the continued integrity of the Indian gaming industry and its regulation.

The Draft Legislation

The draft legislation contains three short sections. The first simply names the act. The second section is what we have come, internally, to call a "CRIT fix." This refers to a recent decision by the United States Court of Appeals for the District of Columbia Circuit in *Colorado River Indian Tribes v. National Indian Gaming Commission*, 466 F.3d 134 (D.C. Cir. 2006). The second section would clarify that NIGC generally has the same oversight authority over Class III gaming that it has over Class II gaming and specifically that it has authority to issue and enforce MICS for Class III gaming operations.

The third and final section of the proposed legislation provides an alternative to NIGC regulation over some parts of Class III gaming. A "Regulatory Committee" appointed by the Secretary of the Interior would draft "minimum standards" for the regulation of Class III gaming. If NIGC then certifies that the regulatory standards in a tribal-state gaming compact meet or exceed those "minimum standards," this "shall preempt the regulation of Class III gaming by the Commission" at the operation that is the subject of the compact.

As to Section 3, the Commission has not yet fully analyzed its provisions, but I have a few preliminary observations. We will send you a further and more complete analysis shortly.

I am aware of the appropriate concern that tribes and states may have regarding how far NIGC might extend its oversight into Class III gaming activities if the changes proposed in Sections 1 and 2 of the draft legislation are enacted. I believe that the "Class III Regulatory Committee" created by Section 3 of the draft legislation is there, in part, to address this concern. The Committee would identify criteria that tribal-state compacts could meet and thus preclude NIGC's further participation in the oversight of that tribe's Class III gaming.

First, I think that history and past practice demonstrates that NIGC has always been careful to tailor its oversight of compacted gaming to complement, not duplicate, the regulation that compacts provide. As noted above, there is much diversity among compacts, and no doubt as future compacts are written, they too will vary from those now in effect.

NIGC is a relatively small organization, and the depth and breadth of Indian gaming already tax its resources. Thus, where adequate oversight arrangements are addressed and implemented by compact, the Commission is careful not to replicate them. This practice saves budget dollars for the Commission and of course saves dollars for the tribes whose fees ultimately fund the Commission's efforts.

Second, history has revealed that in a number of instances, what is provided for in the compacts (in many cases in permissive rather than mandatory form) by way of a State oversight role is implemented only minimally, if at all. In those instances, NIGC has found it appropriate to be more engaged than it otherwise would. Were Section 3 of the proposed legislation enacted, it is possible that standards written by the Regulatory Committee could be met in approved compact language, but if those standards are not

implemented, a serious regulatory oversight vacuum would develop, thereby impairing the integrity of the compacted operation.

Third and finally, IGRA tasks NIGC with many regulatory tasks for Class III gaming that are wholly independent from the NIGC MICS. These include:

- ◆ Approve and enforce provisions of Class III gaming ordinances
- ◆ Approve and ensure compliance with Class III management contracts
- ◆ Ensure that Class III gaming is conducted in conformance with a compact
- ◆ Ensure that Class III gaming is occurring on Indian lands
- ◆ Ensure that net gaming revenues are used for the purposes outlined in IGRA
- ◆ Ensure that tribal revenue allocation plans are followed
- ◆ Ensure that tribes have the sole proprietary interest in their gaming activity
- ◆ Ensure that tribes provide annual audits to the NIGC
- ◆ Ensure that tribes issue facility licenses for their gaming facilities
- ◆ Ensure that gaming facilities are constructed and operated in a manner that adequately protects the environment, public health and safety
- ◆ Ensure that background investigations are conducted on primary management officials and key employees of gaming operations

Presumably there is not an intention in the draft legislation to displace NIGC in those areas, but if the concept of a Regulatory Committee remains in the legislation, clarity should be brought to this area.

Draft Legislation § 2, CRIT fix

As to Section 2, the need for a CRIT solution is paramount for the NIGC. I have testified to the facts and figures many times before your committee. Recently, I testified before the California General Assembly - Government Organization Committee on the need for MICS in an effective regulatory regime.

The battle in California over the need for MICS in their new compacts highlights the importance of the Federal role in a balanced approach to the regulation of Indian gaming.

IGRA envisioned a three legged stool, where balance depended upon all three legs. With the NIGC leg now off the stool, the imbalance has the very real prospect of upsetting the gains gaming has made for Indian people.

In my view, what is at stake is the integrity of Indian gaming. This is not meant to criticize either the tribes or the states. Rather, it is a statement of the obvious. Gaming depends on the public perception and belief in the integrity of operations they choose to patronize. A balanced regulatory approach includes: (1) tribes as the primary regulator with the day-to-day responsibilities and heavy lifting; (2) states having whatever role is provided in the tribal-state compact, usually oversight insuring state policy and applicable laws are adhered to as well as assuring that any revenue sharing payments agreed to are properly calculated and made; and (3) NIGC having the role of making sure that the overall regulation is consistent and fair. Consistent, fair and stable regulation and oversight will continue to foster the growth of Indian gaming.

The model envisioned by IGRA worked for 18 years producing \$25 billion in gaming revenue in 2006. The NIGC has the advantage of seeing Indian gaming all over the country enabling it to spot trends and react to negatives in ways that tribes and states are not usually equipped to do. Further, the NIGC provides a clearinghouse for vital information sharing between the three parties and other stakeholders, such as law enforcement and public safety agencies.

It is the combination of the three that provides the balanced approach that has allowed Indian gaming to succeed and thrive. The proposed legislation in Section 2 addresses this concern by clearly giving the NIGC authority to promulgate and enforce MICS for Class III gaming.

As background about the CRIT case, in early 2001, NIGC attempted to audit a Class II and III gaming operation owned by the Colorado River Indian Tribes (CRIT). NIGC was looking to check compliance with minimum internal control standards or “MICS,” 25. C.F.R. Part 542.

The MICS provide, in considerable detail, minimum standards that tribes must follow when conducting Class II and III gaming. They are intended to embody accepted practices of the gaming industry. To choose a few of many possible examples, the MICS prescribe methods for removing money from gaming machines and gaming tables and counting it so as best to prevent theft; they prescribe methods for the storage and use of playing cards so as best to prevent fraud and cheating; and they prescribe minimum resolutions and floor area coverage for casino surveillance cameras. Attached as Exhibit 1 is a copy of the MICS table of contents, which provides a more detailed overview of their comprehensive scope. More than this, though, the MICS attempt to embody overall controls that reasonably assure gaming transactions are appropriately authorized, recognized and recorded. They thereby assure the integrity of games and safeguard tribal assets, and they do so without displacing internal control requirements that tribes and states have negotiated into their compacts. In the event of a direct conflict between the terms of a compact and the MICS, the MICS specifically state that it is the compact terms that prevail and bind the operation.

In any event, CRIT refused to give NIGC access to its Class III gaming records. The NIGC Chairman responded with a notice of violation and civil fine. CRIT appealed to the full Commission, which upheld the Chairman’s actions. On appeal, the District Court for the District of Columbia granted summary judgment in favor of CRIT, finding that IGRA does not confer upon NIGC the authority to issue or enforce MICS for Class III gaming. The District Court found that while IGRA grants NIGC authority over certain aspects of Class III gaming, MICS are not among them.

On October 20, 2006, the U.S. Court of Appeals for the District of Columbia affirmed the District Court. Though some read the CRIT decision to say that the NIGC has no authority over Class III gaming, the actual holding was narrow: Congress did not give the NIGC the authority to promulgate minimum internal control standards for Class III gaming.

Background

I would like to attempt to explain, in somewhat more detail, my position through the history of the development and implementation of the regulation of this segment of the Indian gaming industry; the tools NIGC has developed and used over the years in which Class III gaming has grown to its present size; how the aforementioned court ruling has had a significant impact on this regulation; and how I think legislation might help insure that the integrity in the operation and regulation of Class III gaming, which has permitted it to become so successful, might be best maintained. As NIGC recently reported, in 2006, tribal gaming generated over \$25 billion in gross gaming revenues. While precise numbers are not required in this connection, NIGC and those who closely watch the Indian gaming industry estimate that nearly 90% of this revenue is generated by compacted, Class III gaming -- far and away the dominant means by which tribes generate gaming revenues.

History of IGRA

It is the NIGC's belief that in IGRA, Congress intended that the Federal entity established to provide oversight of Indian gaming would have an oversight role with respect to the dominant form of gaming in the industry, whether bingo in 1988 or Class III gaming now. If the NIGC's role with respect to its minimum internal control standards and Class III gaming is not clarified by the courts or legislation, most tribes will continue to operate first-rate, well-regulated facilities, and their tribal gaming regulatory entities will perform effectively. Others likely will not.

When the NIGC came on the scene in October of 1988, it believed – and still believes – that its mission was to provide effective oversight of tribal gaming. IGRA states that it established the NIGC as an independent Federal regulatory authority over Indian gaming in order to address Congressional concerns about gaming and to advance IGRA's overriding purposes. These are to ensure that tribal gaming promotes tribal economic development, self-sufficiency and strong tribal governments; to shield gaming from

organized crime and other corrupting influences; to ensure that the tribes are the primary beneficiaries of their gaming operations; and to ensure that gaming is conducted fairly and honestly by both the tribal gaming operations and its customers. IGRA therefore authorizes the Chairman to penalize, by fine or closure, violations of the Act, the NIGC's own regulations, and approved tribal gaming ordinances.

Historically, casino gaming has been a target for illicit influences. Nevada's experience provides a classic case study of the evolution of strong, effective regulation. It was not until Nevada established a strong regulatory structure -- independent from the ownership and operation of the casinos themselves -- and developed techniques such as full-time surveillance of the gaming operations that most potentialities for criminal involvement were eliminated from the gaming industry there. All jurisdictions that have subsequently legalized gaming have looked to Nevada's experience to help guide their own regulation and oversight.

Regulation of Tribal Gaming

IGRA mandates that tribes may conduct Class III gaming only in states where such activity is permissible under state law and where the tribes enter into compacts with states relating to this activity, which compacts require approval of the Secretary of the Interior. Compacts might include specific regulatory structures and give regulatory responsibility to the tribe, to the state, or to both in some combination of responsibilities. Since the passage of IGRA, 232 tribes have executed 249 Class III compacts with 22 states, and the allocation of regulatory responsibility, if addressed at all, is as diverse as the states and tribes that have negotiated them.

In 1987, the Supreme Court decided the *Cabazon* case and clarified that tribes had the right to regulate gambling on their reservations, provided that the states wherein they were located did not criminally prohibit that activity. At that time, large-scale casino gaming operations existed only in Nevada and New Jersey. The Indian Gaming Regulatory Act was passed in 1988 and established the framework for the regulation of tribal gaming. That same year, Florida became the first state in the southeastern United States, and the 25th overall, to create a state lottery. In 1989, South Dakota legalized gambling in the historic gold mining town of Deadwood, and Iowa and Illinois legalized riverboat gambling. The

following year, Colorado legalized gambling in some of its old mining towns, and in 1991, Missouri legalized riverboat gambling. By that time, 32 states operated lotteries, while tribes ran 58 gaming operations. Thus, not just in Indian country but throughout the United States there was at that time a manifest social and political acceptance of gambling as a source of governmental revenue. What is also evident is that when IGRA was adopted in 1988, very few states had experience in the regulation of casino gaming.

When IGRA was enacted, those tribes then engaged in gaming were primarily offering bingo. While there may have been an expectation in Congress that there would be a dramatic change in the games tribes would offer, I think it is reasonable to assume many expected tribal gaming would continue to be primarily Class II, or non-compacted, gaming. After 1988, when tribes began negotiating compacts for casinos with slot machines and banked card games, most of the states they negotiated with had little or no experience in regulating full-time casino operations. Michigan, for example, first compacted with Tribes in 1993 but didn't create its own Gaming Control Board or authorize commercial gaming until the end of 1996. Minnesota began compacting with tribes in 1990 and to this day has no non-Indian casinos within its borders.

A review of compacts approved since 1989 shows that the more recent compacts often address the mechanics of the oversight and regulation of the gaming quite specifically but those earlier compacts, some of which were entered into in perpetuity, do not. Further, the dispute resolution provisions to resolve issues identified by a State's oversight authority in the compacts often employ cumbersome and time-consuming procedures like mediation or arbitration that do not necessarily foster effective regulation. For example, in the 22 states with Class III gaming, 12 provide for some form of mediation or arbitration with varying degrees of specificity and enforceability. Attached as Exhibit 2 is a chart summarizing the internal control and dispute resolution provisions of the compacts in these 22 states.

Typically, the regulatory role a particular state undertakes in its compact was taken from and modeled on that state's experience with the regulation of its own legalized gaming at the time the compact was negotiated. Where such states develop effective regulatory programs, the need for NIGC oversight is greatly reduced. For example, in states where the tribal-state compacts call for regular state oversight, institute technical standards and

testing protocols for gaming machines and establish internal control requirements, the NIGC's oversight role will be limited. This is the case, for example, in Arizona. Some states such as Michigan and North Dakota, however, have assumed a minimal regulatory role. In some cases, compacts have become little more than a revenue sharing agreement between the state and the tribe. Consequently, under circumstances where the states do not have a significant regulatory presence, the NIGC must be in place to undertake a broader range of oversight and enforcement activities.

The History of MICS

The diversity of tribal gaming operations is great. Both rural weekly bingo games and the largest casinos in the world are operated by Indian tribes under IGRA. As the industry grew from its modest beginnings, NIGC needed the appropriate tools to implement its oversight responsibilities. What the Commission lacked was a rule book for the conduct of professional gaming operations and a yardstick by which the operation and regulation of tribal gaming could be measured. During the early stages of the dramatic growth of the Indian gaming industry, some in Congress expressed concerns that uniform minimum internal control standards, which were common in other established gaming jurisdictions, were lacking in tribal gaming. The industry itself was sensitive and responsive to those concerns and a joint National Indian Gaming Association – National Congress of American Indians task force recommended a model set of internal control standards.

Using this model as a starting point, in 1996, the NIGC assembled a tribal advisory committee to assist us in drafting minimum internal control standards applicable to Class II and Class III gaming. These were first proposed on August 11, 1998, and eventually became effective on February 4, 1999. With the adoption of the NIGC's MICS, all tribes were required to meet or exceed the standards therein, and the vast majority of the tribes acted to do so. NIGC's approach during that time was to assist and educate tribes in this regard, not to cite violations and penalize. When shortcomings were encountered by NIGC at tribal operations, NIGC's assistance was offered and grace periods were established to permit compliance.

I served as an Associate Commissioner on the NIGC from 1995 through mid-1999, and I participated in the decision to adopt and implement the MICS. I have now served as the Chairman since December of 2002. It is my confirmed view that the Minimum Internal Control Standards -- given the tribes' strong effort to meet and exceed them and the inspections and audits that NIGC conducts to ensure compliance -- have been the single most effective tool that our Federal oversight body has had to utilize to ensure professionalism and integrity in tribal gaming. The NIGC MICS were embraced by state regulators, several of whom adopted or incorporated NIGC MICS, or compliance therewith, in their compacts.

For six years, NIGC oversight of Class II and Class III gaming with the use of minimum internal control standards went quite smoothly. When necessary, NIGC revised its MICS, and it employed the assistance of tribal advisory committees in doing so. At the time of adoption, of course, many tribal gaming operations and tribal regulatory authorities were already far ahead of the minimums set forth in the MICS. Other tribes, however, had no such standards, and for the first time they had the necessary rule book by which to operate.

NIGC Enforcement of MICS

NIGC employed three methods of monitoring tribal compliance with its MICS. First, the MICS required the tribe to engage an independent Certified Public Accountant to perform what are called "*agreed upon procedures*" to evaluate the gaming operation's compliance with the regulations. The NIGC recommended testing criteria to be used by the external accountant. The results were provided to the tribe and NIGC within 120 days of the gaming operation's fiscal year end. Next, on a regular basis, NIGC investigators and auditors made site visits to tribal gaming facilities and spot checked tribal compliance. Finally, NIGC auditors conducted a comprehensive MICS audit of a number of tribal facilities each year. Typically those audits identified instances wherein tribes are not in compliance with specific minimum internal control standards. Almost always, the non-compliance was then successfully resolved by the tribe. As a result, NIGC was pleased that tribes have a stronger regulatory structure, and tribes were pleased that they have plugged gaps that might have permitted a drain on tribal assets and revenues. Although there have been instances where the non-compliance with the MICS was not resolved, in those

instances the tribes were persuaded to voluntarily close their facilities until the shortcomings were rectified. NIGC has never issued a closure order or taken an enforcement action resulting in a fine for tribal non-compliance with NIGC MICS. It is worth noting that the NIGC recognizes that its success in ensuring tribal gaming operations function in a manner sufficient to safeguard the interests of the stakeholders depends upon the tribes' voluntary compliance. Consequently, the ultimate objective of our audits was to persuade.

Although drawing conclusions based solely on the number of MICS compliance exceptions detected in an audit can be misleading, a look at some of our numbers in this regard can be instructive. Audit reports have reflected as few as ten findings and others over a hundred. However, of the 51 comprehensive audits conducted, only a few have not revealed material internal control weakness. Attached as Exhibit 3 is a table summarizing the number and kinds of MICS violations found from January 2001 through February 2006. Attached as well are representative MICS compliance audit reports.

MICS Compliance

The oversight responsibilities of the NIGC give it a unique view from which to report the variety of challenges confronting Indian gaming in terms of regulatory violations and enforcement actions taken. As said above, the primary responsibility for meeting these challenges is and ought to be on the shoulders of the tribes. The NIGC encourages strong tribal regulation and applauds the resources that Indian gaming currently applies to regulation and other oversight activities. As Indian gaming continues to grow and the sophistication of operations expands and as the levels of the revenues increase accordingly, regulation must stay ahead of this growth if the integrity of the industry is to be protected. I have attached as Exhibits 4 and 5 a timeline and growth chart depicting the growth of tribal gaming operations and revenues, the growth of the National Indian Gaming Commission's staff, and some of the benchmark developments that have occurred during this history. It is in this context that the following examples of the numbers and types of MICS violations the NIGC has uncovered are offered.

The NIGC has compiled the following review of Minimum Internal Control Standards (“MICS”) Compliance Audits – January 2000 to May 2007. The number of tribal gaming operations is taken from those reporting financial information to NIGC.

<u>Gaming Operations</u>	<u>Number of NIGC Audits</u>	<u>Total MICS Violations</u>	<u>Average MICS Violations</u>
367	51	3,335	65

- Findings common to most compliance audits:
 - Lack of statistical game analysis;
 - Ineffective key control procedures;
 - Failure to secure gaming machine jackpot/fill system;
 - Failure to effectively investigate cash variances/missing supporting documentation for the cage accountability/failure to reconcile cage accountability to general ledger on a monthly basis;
 - Inadequate segregation of duties and authorization of player tracking system account adjustments;
 - Ineffective internal audit department audit programs, testing procedures, report writing and/or follow-up;
 - Deficient surveillance coverage and recordings;
 - Noncompliance with Internal Revenue Service regulation 31 CFR Part 103;
 - Failure to exercise technical oversight or control over the computerized gaming machine systems, including the maintenance requirements for personnel access;
 - Failure to properly document receipt and withdrawal transactions involving pari-mutuel patrons’ funds and a lack of a comprehensive audit procedures of all pari-mutuel transactions;
 - Failure to adequately secure and account for sensitive inventory items, including playing cards, dice, bingo paper and keno/bingo balls; and

- Failure to adopt appropriate overall information technology controls specific to hardware and software access to ensure gambling games and related functions are adequately protected.

Although exact data is not available regarding losses to tribal gaming operations resulting from the above control deficiencies, based on the past experience of commercial gaming, we can conclude the amount to be in the millions each year. These violations show that certain tribes are not adequately protecting their gaming assets.

In California, for example, between 2002 and 2006, the NIGC conducted 8 audits that produced findings indicating that one gaming operation possessed an exemplary system of internal controls, four were reasonably effective but had multiple material control weaknesses and three had a system of internal controls considered to be dysfunctional.

Breakdown in Tribal Regulation

Beyond the MICS, the NIGC oversight has uncovered serious breakdowns in regulation at Class II and Class III tribal gaming operations throughout the country. This is true even where there is apparent adequate tribal regulation and control in place.

- Examples of instances where tribal gaming operational and regulatory efforts have been found deficient include the following:
 - During the course of investigations and MICS compliance audits, NIGC investigators and auditors discovered that an extraordinary amount of money was flowing through two Class III off track betting (OTB) operations on two reservations. The amount of money was so high in comparison to the amount that could reasonably flow through such OTB operations that our investigators immediately suspected money laundering or similar activities. These two operations were the first referrals to the FBI's working group in which we participate. The FBI investigations found that these operations were part of a wide spread network of such operations with organized crime links and several Federal criminal law violations. Unfortunately, the tribes' gaming management allowed them to gain access and operate as part of their Class III tribal gaming operations, and the

tribes' gaming regulators completely failed to take any action against these illegal OTB operations.

- There are also examples where tribes continued to operate, without modification or correction, a gaming facility that permitted gaming activities to be conducted by companies owned by individuals with known criminal associations; distributed large amounts of gaming revenues without requisite approved revenue allocation plans or the financial controls necessary to account for them; knowingly operated gaming machines that were plainly illegal; and appointed gaming commissioners and regulatory employees and licensed and employed gaming employees whose criminal histories indicated that they were unsuitable and serious risks to the tribes' gaming enterprise. An accurate assessment of Indian gaming regulation must also reflect the unfortunate examples of tribes that are so politically divided that they are unable to adequately regulate their gaming activities, as well as instances where tribal officials have personally benefited from gaming revenues at the expense of the tribe itself. In addition, there have been many instances where apparent conflicts of interest have undermined the integrity and effectiveness of tribal gaming regulation. In all of these troubling situations, it was necessary for the NIGC to step in to address the problems. The above examples illustrate that Indian gaming has many regulatory challenges that without comprehensive, well informed oversight and enforcement the integrity of the industry would be in jeopardy.

The NIGC has compiled a list of potential risks to Indian gaming if strong oversight is not maintained:

- Risk of not detecting employee embezzlement;
- Risk of not detecting manipulations and/or theft from gaming machines;
- Risk of not detecting criminal activity or the presence of organized crime influence;
- Risk of not detecting misuse of gaming revenues by tribal officials;

- Inability to effectively determine whether third parties are managing the gaming facility without an approved contract;
- Inability to effectively determine whether imminent jeopardy exists with regard to the safety of employees and patrons of the gaming establishment;
- Inability to effectively determine whether individuals other than the recognized tribal government are asserting authority over the gaming operation;
- Inability to effectively determine whether outside investors have unduly influenced tribal decision-making or made improper payments to tribal officials;
- Inability to effectively perform operational audits, which track the movement of money throughout the casino;
- Risk that tribal surveillance and gaming commission funding could decrease rapidly, as these are expensive and are not seen as increasing the casino bottom line.

Potential Impact of CRIT Decision

Finally, I would like once again to return the significance of the CRIT decision and the importance that NIGC places upon a CRIT fix. IGRA, in effect, anticipated the wide range of regulatory structures in the various tribal-state compacts through the establishment of the NIGC as an independent federal regulatory authority for gaming on Indian lands. With respect to NIGC's regulatory oversight responsibilities, IGRA authorized the Commission to penalize violations of the Act, violations of the Commission's own regulations, and violations of the Commission-approved tribal gaming ordinances by the way of imposition of civil fines and orders for closure of tribal gaming facilities.

A luxury that tribal gaming regulators have, when contrasted to the NIGC and state regulators, is that ordinarily their regulatory responsibility is confined to one, or in some cases several, tribal gaming facilities. The laser-focus this permits undoubtedly has advantages. However, states, and NIGC, have an advantage not permitted in such an arrangement, and that is ability to look at a broad range of gaming operations, permitting them to contrast and compare methodologies and trends, and perhaps thereby identifying issues that would not be apparent to a regulator with primary exposure to only one

operation. (Such operation being owned by the entity which controls the purse strings for the tribal regulatory body itself.) Thus, the combined approach—tribes having the heavy lifting—the all day, every day responsibility and the NIGC and the states having a less immediate but independent oversight perspective, seeing multiple operations, affords an important perspective which would otherwise not be available. In an arrangement where states do not bring this perspective to the arrangement—or where NIGC cannot bring it, this synergy envisioned by the authors of IGRA is lost.

More specifically, since the *Colorado River Indian Tribes* decision, the NIGC has discontinued the practice of Class III gaming reviews conducted by our auditors. There will be temptations, generated by demands for per capita payments or other tribal needs, to pare down tribal regulatory efforts and bring more dollars to the bottom line. There will be no federal standard that will stand in tribes' way should this occur. For the most part, the NIGC will become an advisory commission rather than a regulatory commission for the vast majority of tribal gaming. The very integrity of the now-smoothly-operating regulatory system, shared by tribal, state and federal regulators, will be disrupted. If there is one imperative change that needs to be made in the Indian Gaming Regulatory Act, in the view of this NIGC Chairman and consistent with the legislative proposal that the NIGC sent to this Congress in May of 2007, it is the clarification that NIGC has a role in the regulation of Class III gaming.

Not everyone agrees, of course. Some tribes argue that the CRIT decision should be read broadly to eliminate any NIGC authority over Class III gaming. This interpretation may impact on the ability of the NIGC to enforce its regulations as follows:

<u>Activity</u>	<u>Impact</u>
Bingo	Unchanged
Pull-Tabs	Unchanged
Card Games	Unchanged
Keno	No enforcement authority
Pari-Mutuel Wagering	No enforcement authority
Table Games	No enforcement authority
Gaming Machines	No enforcement authority
Cage	Scope limited – Bingo/Pull-Tab/Card Game Inventory Items
Credit	Scope limited – Bingo/Pull-Tab/Card Game

	Inventory Items
Information Technology	Scope limited – Bingo/Pull-Tab/Card Game Related Software and Hardware
Complimentary Services and Items	Scope limited – Bingo/Pull-Tab/Card Game Transactions
Drop and Count	Scope limited – Bingo/Pull-Tab/Card Game Cash, Cash Equivalents and Documents
Surveillance	Scope limited – Bingo/Pull-Tab/Card Game Areas
Internal Audit	Scope limited – Bingo/Pull-Tab/Card Game Transactions

One of the daunting challenges facing the NIGC is answering the question: “Where does the Class II end and the Class III begin?” In most Indian gaming establishments there is no segregation of internal controls between Class II and Class III. We can audit Class II games without auditing Class III, for instance bingo versus blackjack. However, when it comes to comps and surveillance and other more general areas it gets tricky. In most instances, the proceeds are combined or commingled and auditors then can’t look at one revenue stream without observing the other. This gray area has the potential to hinder our mission.

The above examples illustrate that the regulation of Indian gaming is a complicated matter. At the tribal level it can often be impacted by political discord that may lead to uneven enforcement or at times little effect regulation regardless of overall intention. It is nevertheless clear that tribes have a very strong interest in assuring that their operations are adequately regulated.

Challenges to the Independence of Tribal Regulation

That said, some gaming commissions are not sufficiently independent of the tribal governments or the managers that operate the gaming operation. In this connection, the history of Nevada’s regulatory structure may be instructive. Effective gaming regulatory authority in Nevada was a process that evolved over a forty year period and is continuing to improve and respond to change today. Only after creation of a separate gaming regulatory authority did oversight of the industry have an effective champion. Beginning in the late 70’s, significant progress was made into the identification and removal of individuals and entities intent upon exploitation and corruption. Although many factors

contributed to corruptive influences in Nevada, one aspect stood out. At the time gaming was legalized in Nevada, the state and local governments were in a rather deprived financial position therefore the governmental agencies charged with regulatory oversight were also dependent, albeit desperate, for the potential revenues this growing industry could provide. The Nevada experience demonstrates a critical policy question when gaming regulations are considered: that as the government charged with regulation becomes increasingly dependent upon the profitability of the industry being regulated, the effectiveness of the regulatory effort may diminish.

Generally, in tribal gaming, the tribal council is the ultimate governmental authority responsible for ensuring the gaming operation generates the greatest return on investment and that, in doing so, is effectively regulated. Such an organizational structure has challenges because the motivations lack congruity. Inevitably, from time to time, one objective may be foregone in pursuit of the other and, many times it is the oversight function. Although some tribes have recognized the organizational weakness and have installed procedures to counteract its effect, others have not and, as a result, the effectiveness of their regulatory processes is significantly diminished.

In sum, the result of the CRIT decision is that Class III gaming is left with tribal-state compacts as the remaining vehicle for oversight and enforcement. The information I have attempted to present here shows, I believe, many of the structural weaknesses of that situation. While NIGC has no role, compacts are lacking in the area of enforcement. Compacts might include specific regulatory structures and give regulatory responsibility to the tribe, to the state, or to both in some combination of responsibilities. In two states, Arizona and Washington, the tribal-state compacts call for regular state oversight, institute technical standards and testing protocols for gaming machines, and establish internal control requirements. Most states, however, have assumed a minimal regulatory role. In many cases, compacts have become little more than a revenue sharing agreement between the state and the Tribe. The absence of the NIGC in the regulation of Class III gaming removes an essential component of oversight and enforcement.

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§ 542.22 What are the minimum internal control standards for internal audit for Tier A gaming operations?

§ 542.23 What are the minimum internal control standards for surveillance for Tier A gaming operations?

§ 542.30 What is a Tier B gaming operation?

§ 542.31 What are the minimum internal control standards for drop and count for Tier B gaming operations?

§ 542.32 What are the minimum internal control standards for internal audit for Tier B gaming operations?

§ 542.33 What are the minimum internal control standards for surveillance for Tier B gaming operations?

§ 542.40 What is a Tier C gaming operation?

§ 542.41 What are the minimum internal control standards for drop and count for Tier C gaming operations?

§ 542.42 What are the minimum internal control standards for internal audit for Tier C gaming operations?

§ 542.43 What are the minimum internal control standards for surveillance for a Tier C gaming operation?

Tribal-State Compact MICS and Dispute Resolution Provisions as of 9/21/05

State	MICS Provisions	Remedy for Compact Violation	Expiration Date
Arizona	All Arizona compacts adopt NIGC MICS	Non-binding mediation; binding arbitration; injunctive relief.	2013, 2014, and 2018
California 1999 Compacts	1) Tribes must record all incidents in a special log; 2) Tribes must maintain a list of barred persons; 3) Tribes must post the rules and regulations of table games. Gaming devices transported off Tribe's land subject to seizure.	Tribal gaming agency investigates, requires correction; if none, fines or sanctions. Disputes: Tribe and State meet and confer, then arbitration with judicial review. No Class III gaming if Tribe 2 quarterly contributions overdue.	2020
California 2004 amended Compacts	Requires testing of gaming devices.	No change.	2025, 2030
Colorado	Tribal TICS with State review.	Arbitration for breach of contract provisions.	None. In effect until termination by both parties.
Connecticut	Extensive, comprehensive MICS	Mashantucket Pequot - procedure for appeal by Tribe to State Sup. Ct. of assessments levied by State. If non-compliance with Compact, US Dist. Ct. or petition NIGC. Mohegan - none.	None. Termination by written agreement of parties.
Idaho	Three of the four compacts include fairly general MICS. One of the compacts (Shoshone Bannock) includes only very general control language.	Three of the four compacts provide for meet-and-confer, then binding arbitration with no judicial review. One of the compacts (Shoshone Bannock) allows actions in federal district court after the arbitration	Until renegotiated or replaced.
Iowa	NIGC MICS adopted for accounting and cash control. Equivalent surveillance standards adopted in compacts. Semi-annual audit required to determine compliance with compact and all applicable laws.	If Tribe fails to comply, Compact may be suspended. If State fails to comply, Tribe may seek any remedy.	2006, 2012, 2019
Kansas	All Kansas compacts have MICS that cover cage operations, drop and count, fill and credit, and surveillance, but are not as comprehensive as NIGC minimums. Other areas not covered.	State and Tribe will report violations to each other. Arbitration and/or judicial resolution in federal court. Limited to equitable remedies and costs for state oversight.	None
Louisiana	Minimal MICS; limited surveillance procedures for cashier's cash and cash control management in Appendix.	Informal resolution for at least 45 days. If none, then formal mediation. If no resolution, then binding arbitration.	2007 and 2008
Michigan	None.	Tribe and State to meet. State has right to notify Tribe to stop playing game. Tribe can stop or go to arbitration.	2013 and 2019
Minnesota	Some compacts have none. Others have minimal surveillance regulations for blackjack tables.	Tribe may contest allegation of non-compliant game through inspection by independent gaming laboratory or in Federal court, before NIGC, or in State court, respectively, if prior forum declines jurisdiction.	None
Mississippi	No MICS in Compact, but limited MICS for slot machines in gaming ordinance.	1) informal dispute resolution; 2) if no resolution, then arbitration, with decision of arbitrator final and non-reviewable.	None. Termination by mutual consent of the parties.

State	MICS Provisions	Remedy for Compact Violation	Expiration Date
Montana	None	State or Tribe can terminate compact on 90 days notice if violation not cured. Efficacy of cure may be adjudicated in Federal Court.	Various none, 2006, 2007, 2008 and until another compact signed.
Nevada	Two compacts require following Nevada MICS, four compacts require adopting MICS at least as stringent as Nevada MICS.	Four have dispute resolution with judicial remedies thereafter. Two have none.	Varied - either "until gaming ceases on property" or 4-year terms and can be terminated by mutual consent.
New Mexico	None	Compact provides an arbitration provision for dispute resolutions or compact compliance. The result of the arbitration is final and binding, and may be enforceable by any court of competent jurisdiction.	2015
New York	Comprehensive MICS, similar to NIGC's.	Informal dispute resolution. If no resolution, then binding arbitration. Cessation of tribal payments to state if breach of exclusivity provisions (two of three tribes).	None & 2016
North Carolina	Very limited MICS. Transactions in machines recorded and stored with software; rules of play displayed.	Internal dispute resolution process (notice, 30 days to try to resolve). If not resolved, any legal remedy available or by mutual agreement, mediation, arbitration or other alternative method.	2031 with automatic 5 year extensions if no non-renewal notice from either party.
North Dakota	MICS are NIGC's MICS.	Meet to discuss. Subsequently, Tribe may go to arbitration over State violation. State may go to arbitration or Federal Court over Tribe violation. Issues of non-compliant Class III games are to be resolved through examination by independent testing laboratory.	2008, 2012 and subsequent renewals.
Oklahoma	Model compact: Tribal internal control standards must equal or exceed NIGC MICS.	Model compact: Arbitration for enforcement of compact provisions. Federal court de novo review of arbitration award, subject to appeal to Circuit Court.	2020, automatic 15 year renewals.
Oregon	Comprehensive Tribal/State MICS (set forth in compacts)	Meet-and-confer, then federal district court or state court if the federal court lacks jurisdiction.	None
South Dakota	South Dakota State MICS incorporated by reference.	Termination on breach, action in Federal Court available for interpretation of compact. For non-compliant machines, arbitration.	2005, 2006, 2007, 2008, and subsequent renewals.
Washington	Comprehensive MICS (set forth in compact)	Some slight variation among the 27 compacts, but State may always seek injunctions in federal district court. Either binding or non-binding arbitration provisions also incorporated.	Termination by written agreement of the parties.
Wisconsin	Tribe to use MICS at least as restrictive as NIGC's.	In order, negotiation, mediation, arbitration, action in Federal court (certain provisions may be sued upon immediately).	None or 2009

Exhibit # 3 MICS Compliance Audits – February 2000 to May 2007

1/2

<u>Region</u>	<u>Gaming Operations</u>	<u>Number of Audits</u>	<u>Total MICS Violations</u>	<u>Average MICS Violations</u>
1 – Portland	44	10	635	64
2 – Sacramento	52	6	410	68
3 – Phoenix	43	8	297	37
4 – St. Paul	117	7	546	78
5 – Tulsa	84	4	356	89
6 – DC	27	2	111	56
Totals	367*	51	3335	65

* - number from audited financials

* 7 MICS Compliance audits per year on average

* In the past year 11 MICS Audits delivered with 559 Violations

Exhibit # 3 MICS Compliance
2/2

- Findings common to most MICS compliance audits:
 - Lack of statistical game analysis;
 - Ineffective key control procedures;
 - Failure to secure gaming machine jackpot/fill system;
 - Failure to effectively investigate cash variances/missing supporting documentation for the cage accountability/failure to reconcile cage accountability to general ledger on a monthly basis;
 - Inadequate segregation of duties and authorization of players tracking system account adjustments;
 - Ineffective internal audit department audit programs, testing procedures, report writing and/or follow-up;
 - Deficient surveillance coverage and recordings;
 - Noncompliance with Internal Revenue Service Regulation 31 CFR Part 103;
 - Failure to exercise technical oversight or control over the computerized gaming machine systems, including the maintenance requirements for personnel access;
 - Failure to properly document receipt and withdrawal transactions involving pari-mutuel patrons' funds and a lack of a comprehensive audit procedures of all pari-mutuel transactions;
 - Failure to adequately secure and account for sensitive inventory items, including playing cards, dice, bingo paper and keno/bingo balls; and
 - Failure to adopt appropriate overall information technology controls specific to hardware and software access to ensure gambling games and related functions are adequately protected.

Exhibit # 4

Growth in Tribal Gaming

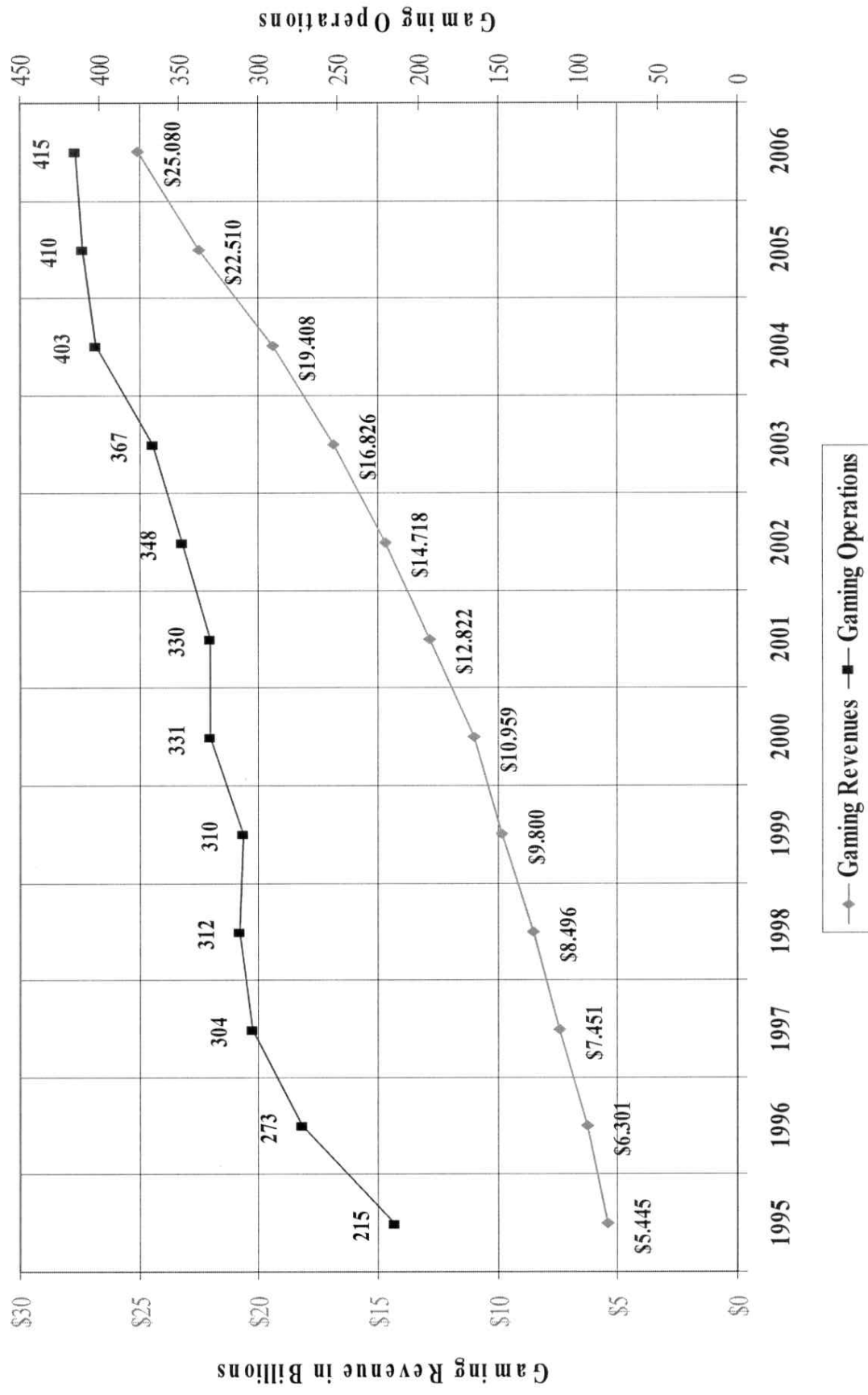


Exhibit # 5

2006 Tribal Gaming Revenues

	Number of	Revenues	Percentage of		Mean	Median
Gaming Revenue Range	Operations	(in thousands)	Operations	Revenues	(in thousands)	(in thousands)
\$250 million and over	23	11,214,822	5.9%	44.7%	487,601	414,840
\$100 million to \$250 million	40	6,730,419	10.3%	26.8%	168,261	157,987
\$50 million to \$100 million	45	3,186,109	11.6%	12.7%	70,802	67,211
\$25 million to \$50 million	64	2,241,013	16.5%	8.9%	35,016	32,652
\$10 million to \$25 million	72	1,229,246	18.6%	4.9%	17,073	17,413
\$3 million to \$10 million	66	412,702	17.1%	1.6%	6,253	6,458
Under \$3 million	77	61,518	19.9%	0.2%	799	286
Total	387	25,075,829				