COUNCIL AGENDA: 06-15-10
ITEM: 3.15

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Lee Price, MMC
City Clerk

SUBJECT: **SEE BELOW**

DATE: 06-01-10

SUBJECT: REPORT FROM THE CITY AUDITOR ON THE AUDIT OF THE CITY'S LICENSING AND PERMITTING OF CARDROOM OWNERS AND EMPLOYEES

RECOMMENDATION

As recommended by the Public Safety, Finance and Strategic Support Committee on May 20, 2010 and outlined in the attached memo previously submitted to the Public Safety, Finance and Strategic Support Committee, accept the Report from the City Auditor on the Audit of the City's Licensing and Permitting of Cardroom Owners and Employees.

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Auditor

Report to the City Council
City of San José

AUDIT OF THE CITY'S LICENSING AND PERMITTING OF CARDROOM OWNERS AND EMPLOYEES

The City's Processing of Key Employee and Owner Licensing Is Overly Rigorous and Should be Redesigned

The City's Processing of Work Permits Has Been Slow

Report 10-06
April 2010

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Auditor
Sharon W. Erickson, City Auditor

April 7, 2010

Honorable Mayor and Members
of the City Council
200 East Santa Clara Street
San Jose, CA 95113

Transmitted herewith is *Audit of the City's Licensing and Permitting of Cardroom Owners and Employees.* This report is in accordance with City Charter Section 805. An Executive Summary is presented on the blue pages in the front of this report. The City Administration's response will be distributed under separate cover.

This report will be presented at the April 15, 2010 meeting of the *Public Safety, Finance & Strategic Support Committee.* If you need any additional information, please let me know. The City Auditor's staff members who participated in the preparation of this report are Steve Hendrickson, Gitanjali Mandrekar, and Diana Chavez.

Respectfully submitted,

Sharon W. Erickson
City Auditor

finaltr
SE:bh

cc: Debra Figone, Deanna Santana, Nadine Nader, Rob Davis, Richard Doyle, Dan Katz, Richard Teng, Scott Johnson, Nora Frimann, Carl Mitchell, Mike Ryder, Ronald Werner, Eric Swallow, Harold Furtado, Matt Love

200 E. Santa Clara Street, San José, CA 95113
Telephone: (408) 535-1250 ***Fax:*** (408) 292-6071 ***Website:*** www.sanjoseca.gov/auditor/

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Auditor

Report to the City Council
City of San José

AUDIT OF THE CITY'S LICENSING AND PERMITTING OF CARDROOM OWNERS AND EMPLOYEES

Table of Contents

Executive Summary i

Introduction 1

Background 1

Audit Scope and Methodology 8

Finding I
The City's Processing of Key Employee and Owner Licensing Is Overly Rigorous and Should be Redesigned 11

The California Bureau of Gambling Control Investigates the Qualifications of Individuals Who Desire to Be Owners or Key Employees in the City's Cardrooms 12

The Cost of Regulating Cardrooms in San José Is Higher than All But One California Jurisdiction That We Surveyed 13

The DGC Has a Significant Backlog of Key Employee License Investigations Which it Has Not Started or Not Completed 16

Redesigning Its Licensing Work Would Allow the DGC to Focus Even Further on Its Other Regulatory Activities 18

The DGC Should Track Its Costs of Each Licensing Review 20

The City Needs to Ensure That It Uses Actual Costs When Calculating Table Fees 21

Finding II
The City's Processing of Work Permits Has Been Slow 23

Title 16 of the San José Municipal Code Requires All Cardroom Floor Employees to Have a Work Permit 23

The Current Work Permitting Process Oftentimes Takes More Than One Month to Issue 25

Appendix A
Definition Of Priority 1, 2, And 3 Audit Recommendations A-1

Appendix B
Other Duties B-1

Appendix C
Allocation of Work Duties C-1

Table of Exhibits

Exhibit 1: DGC Organizational Structure 3

Exhibit 2: DGC Budget for Fiscal Years 2004-05 to 2009-10 4

Exhibit 3: San José Cardroom Tax Revenue from 2005-06 to 2008-09 5

Exhibit 4: Total Arrests Made at Both Cardrooms from 2001-02 to 2007-08 8

Exhibit 5: Comparison of the Estimated Cost of Background Investigations by San José and State of California 13

Exhibit 6: Comparison of Table Fees by Cardroom and Jurisdiction FY 2009-10 15

Exhibit 7: Summary of the DGC's License Application Workload From 2002 Through 2010 (as of March 23, 2010) 16

Exhibit 8: Breakdown of the DGC Work Duties by Percent as of February 2010 18

Exhibit 9: Estimated Cardroom Regulation Costs FY 2009-10 22

Exhibit 10: Flow Chart of San José's Current Cardroom Work Permit Process 24

Executive Summary

In accordance with the City Auditor's 2009-10 Audit Workplan, we have completed an audit of the Division of Gaming Control's Licensing and Permitting of Cardroom Owners and Employees. The purpose of our review was to assess the efficiency and effectiveness of the City's licensing and permitting process for cardroom owners and employees, including benchmarking the scope and cost of cardroom employee background investigations and the cost of oversight. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the Audit Objective, Scope, and Methodology section of this report.

The Office of the City Auditor thanks the management and staff of the Division of Gaming Control, the Office of the City Manager, the Office of the City Attorney, and senior staff from Garden City, and Bay 101 for their cooperation and assistance during our review.

Finding I The City's Processing of Key Employee and Owner Licensing Is Overly Rigorous and Should be Redesigned

State law requires that every cardroom owner[1] or key employee[2] of a gambling establishment obtain and maintain a valid State gambling license. The Bureau of Gambling Control investigates the qualifications of individuals who apply for State gambling licenses to determine whether they are suitable and to ensure that gambling is conducted honestly, competitively, and free from criminal and corruptive elements. Title 16 of the San José Municipal Code requires that cardroom owners or employees obtain a valid City of San José -issued gaming license. We found that:

[1] Per §16.02.460 of the San José Municipal Code, *"Owner" means every person who owns an interest in any Cardroom or Cardroom Permittee.*

[2] Per §16.02.420 of the San José Municipal Code, *"Key Employee" means any person employed in the operation of a Cardroom in a supervisory capacity who is authorized or empowered to make discretionary decisions with regard to Gambling operations, including, without limitation, shift managers, credit executives, cashier operations supervisors, Gambling operation managers and assistants, managers or supervisors of security personnel, surveillance managers or supervisors, or any other person designated as a Key Employee by the Administrator because the Administrator believes the person has the power to exercise a significant influence over the gaming operation of the Cardroom Permittee or for other reasons consistent with the public interest, and the policies of this Title.*

- Both the California Bureau of Gambling Control and the City's DGC investigate the qualifications of individuals who desire to be owners or key employees in the City's cardrooms;
- The cost of regulating cardrooms and licensing in San José is higher than all but one California jurisdiction that we surveyed;
- The DGC has a significant backlog of key employee license investigations which it has not started nor completed and as a result has issued various temporary licenses;
- Title 16 provides broad latitude on determining the scope of its license investigations, however, the guideline is to complete license investigations in 180 days;
- Redesigning its licensing work would allow the DGC to even further focus on its other regulatory activities;
- The DGC should track costs of each licensing review; and
- The City needs to ensure it uses actual costs when calculating table fees.

In our opinion, the license backlog cannot be addressed by simply adding more staff. The DGC needs to take advantage of opportunities to become a more efficient regulator. First, the City should amend Title 16 to require and rely solely on the State's key employee license for issuing a San José key employee license thereby reducing the DGC's workload while preserving the City's ability to impose limitations and conditions on these licenses including the ability to retract the license based on the key employee's violations of Title 16. Second, the City should abide by the Title 16 guideline that license investigations should be completed in 180 days and develop clear written guidelines for when investigations can extend beyond 180 days. Furthermore, to better manage its pending license investigations the City should redesign its background investigations to a) better provide clearer guidance on the desired scope of the licensing process, b) be more limited in scope and c) track and report the status and cost of these pending and incomplete license investigations through the Annual Report to the City Council. Finally, the City should liquidate the two encumbrances in the DGC's fund and use the funds to offset DGC costs.

RECOMMENDATIONS

We recommend that the City Administration:

Recommendation #1 **Retain the City's licensing of cardroom owners, and propose amendments to Title 16 to require and rely solely on the State's key employee license for issuing a San Jose key employee license thereby reducing the DGC's workload while preserving the City's ability to impose limitations and conditions on these licenses including the ability to retract the license based on the key employee's violations of Title 16. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)**

We recommend that the City Administration:

Recommendation #2 **Abide by the Title 16 guideline that license investigations should be completed within 180 days and develop clear written guidelines for when investigations can extend beyond 180 days. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)**

Recommendation #3 **To better manage its backlog of pending license investigations, redesign its background investigations to: a) provide clearer guidance on the desired scope of the DGC licensing process, b) be more limited in scope, and c) track and report the status and cost of these pending and incomplete license investigations through the Annual Report to the City Council. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)**

Recommendation #4 **Implement procedures to track time and costs of each licensing review, provide an itemized accounting to each applicant at the end of each review, and include the per applicant cost in the Annual Report to City Council. (Priority 2)**

Recommendation #5 **Liquidate the two encumbrances in the DGC's fund and use the funds to offset DGC costs. (Priority 2)**

Finding II The City's Processing of Work Permits Has Been Slow

The DGC's processing of work permits has been slow and needs to be improved. We found that:

- Title 16 of the San José Municipal Code requires all cardroom employees to have a work permit;
- The current work permitting process oftentimes takes more than one month to issue;
- The DGC recently made attempts to streamline the permitting process;
- The DGC should review and determine whether it can do work permits in-house, and;
- Other California jurisdictions rely on the State to process work permits.

In our opinion, the Administration should either propose revisions to Title 16 to discontinue the City's permitting function and accept State-issued portable gaming work permits, or process work permits within the DGC. If the Administration chooses to

process work permits within the DGC we also recommend that a) the DGC continue to streamline and develop a work permitting approval and renewal process that strictly abides by the Title 16 guideline to issue work permits within 20 working days, and b) that the Administration analyze the cost recovery status of work permit fees.

RECOMMENDATION

We recommend that the City Administration:

Recommendation #6

1. **Propose revisions to Title 16 to discontinue the City's permitting function and accept State-issued portable gaming work permits, or**
2. **Process work permits within the DGC.**

If the Administration chooses to process work permits within the DGC we also recommend that: a) the DGC continue to streamline and develop a work permitting approval and renewal process that strictly abides by the Title 16 guideline to issue work permits within 20 working days, and b) the Administration analyze the cost recovery status of work permit fees. (Priority 3)

Introduction

In accordance with the City Auditor's 2009-10 Audit Workplan, we have completed an audit of the Division of Gaming Control's Licensing and Permitting of Cardroom Owners and Employees. The purpose of our review was to assess the efficiency and effectiveness of the City's licensing and permitting process for cardroom owners and employees, including benchmarking the scope and cost of cardroom employee background investigations and the cost of oversight. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the Audit Objective, Scope, and Methodology section of this report.

The Office of the City Auditor thanks the management and staff of the Division of Gaming Control, the Office of the City Manager, the Office of the City Attorney, and senior staff from Garden City, and Bay 101 for their cooperation and assistance during our review.

Background

Cardrooms have existed in the State of California (State) since before statehood. They were a particularly popular form of entertainment during the Gold Rush, when gambling was pervasive. From the 1860s through the 1980s, the poker club, or cardroom, was the major form of gambling in the State, with the house acting as a neutral overseer of the games. The clubs were regulated at the local level with minimal State oversight. Rather than having a stake in the game (house-banked) and taking a percentage of the wager, California cardrooms provide a house dealer and charge a player participation fee by time period (generally every half hour) or by hand played. Cardrooms are limited in the types of games that they can offer by the California Constitution, which reserves house-banked Nevada-style casino games for casinos operated by tribes that have federally-approved tribal-state gaming compacts.[1]

The City currently has two cardrooms—Sutter's Place Inc. (dba[2] Bay 101) and Garden City. Each cardroom currently has 40 card tables. Bay 101 is located at

[1] Source: Wear Simmons Ph.D., Charlene, *Gambling in the Golden State 1998 Forward*, California Research Bureau, May 2006.

[2] Doing Business As.

1801 Bering Dr, San José, CA and Garden City is located at 360 Saratoga Ave, San José, CA.

On March 9, 2010, the San Jose City Council voted to place a measure on the June 2010 ballot to "increase the cardroom tax rate on gross revenues from 13% to 15%, increase the number of cardroom tables by 18, permit any card game authorized under State law consistent with City regulations and betting limits authorized under State law, all subject to City audit and oversight."

Title 16 and Establishment of the Division of Gaming Control

City regulation of cardrooms is established under Title 16 of the San José Municipal Code. The purpose of Title 16 is *"Effective and comprehensive regulation of the practices, activities, persons and places associated with or involved in gaming in San José [which] is essential for the protection of the public health, safety and welfare."* Further, the purpose is *"to maintain public confidence [...] in the integrity of the Cardroom operations by requiring strict regulatory controls and enforcement practices to carefully monitor gaming activity at the Cardrooms."*

The Division of Gaming Control

Title 16 establishes the Division of Gaming Control (DGC) within the San José Police Department (SJPD). The DGC is charged with carrying out the licensing, work permitting, revenue and tax auditing, regulatory compliance testing, regulation promulgating, and other administrative functions over the permitted cardrooms pursuant to the regulatory program. In general, the responsibilities of the DGC can be divided into two categories: administration and regulation, and permits and licensing. The following list enumerates some of the functions for each category:

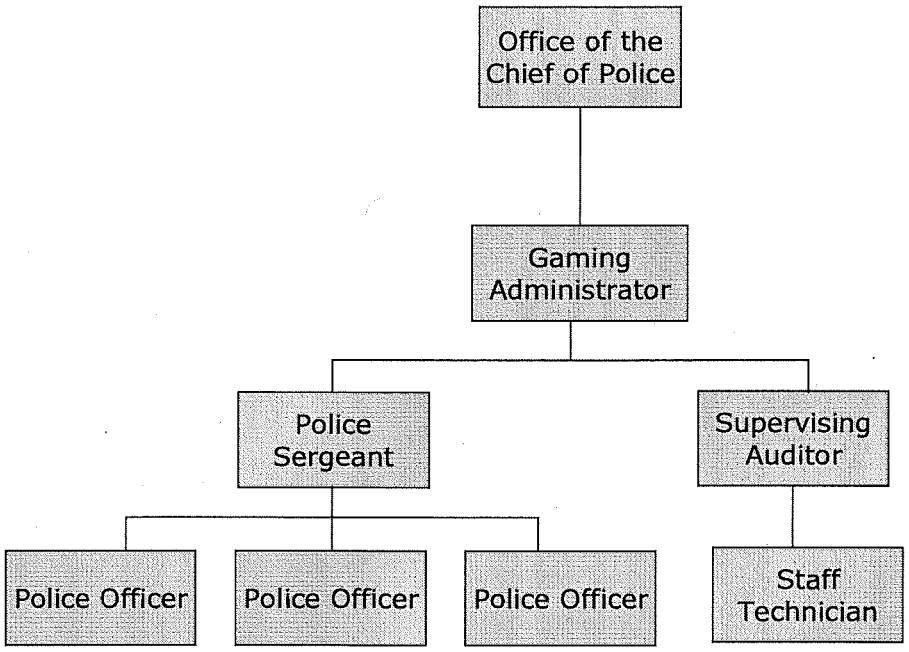
Administration & Regulation	Permits & Licensing
o Promulgate and enforce gaming statutes and rules and regulations o Audit the books and records of the cardrooms o Inspect the gaming operations o Investigate customer complaints	o Perform criminal and civil background investigations of license applicants o Perform financial analysis of stockowners and key employees o Perform investigation of renewal applicants o Review and approve all cardroom work permit applicants

Appendix B of this report provides a descriptive narrative of activities performed by the DGC.

DGC Organization

The DGC includes 7 full-time equivalent employees: the Gaming Administrator, one Police Sergeant, three Police Officers, one Supervising Auditor, and one Staff Technician. Exhibit 1 below illustrates the DGC organizational structure.

Exhibit 1: DGC Organizational Structure



Source: Auditor-prepared based on information provided by the DGC.

The Gaming Administrator heads the DGC and is appointed by the City Manager and reports directly to the Chief of Police. The DGC Police Officers and the Sergeant serve a 4 and 6 year rotation respectively, and rotate out of the DGC once they have completed their rotation period. One of the DGC Police Officers also performs background investigations for employee work permits[3]. The DGC Supervising Auditor does financial background investigations for key employees and owners, compliance reviews and monitors cardroom gaming revenues. According to the City Administration, the current staffing level in the DGC is unable to keep pace with the workload and has requested that City Council approve two more auditors for the DGC.

[3] We will discuss key employee and stockowner licenses and work permits in detail in Finding I and II.

Prior Civilianization Audit

The DGC's four sworn positions were part of the 88 positions, recommended for civilianization in the City Auditor's January 2010 *"Audit of Civilianization Opportunities in the San José Police Department"*. That audit recommended that the SJPD review and propose a short-term and long-term plan on civilianization opportunities within the SJPD. The audit estimated that civilianizing the DGC's four sworn positions and replacing these with one Analyst II and three Senior Office Specialists would save the DGC $258,000. The SJPD generally agreed to consider the recommendations. Implementation is pending.

DGC Budget

The DGC's current adopted budget is about $1.3 million.[4] Exhibit 2 below illustrates the DGC's adopted budget for the past six years.

Exhibit 2: DGC Budget for Fiscal Years 2004-05 to 2009-10

Year	Personal Services Budget in $	Non-Personal Services Budget in $	**Total Budget**
2004-05	935,309	184,594	1,119,903
2005-06	897,803	192,141	1,089,944
2006-07	1,001,133	193,077	1,194,210
2007-08	1,078,916	242,372	1,321,288
2008-09	1,127,062	194,379	1,321,441
2009-10	1,159,889	162,373	1,322,262

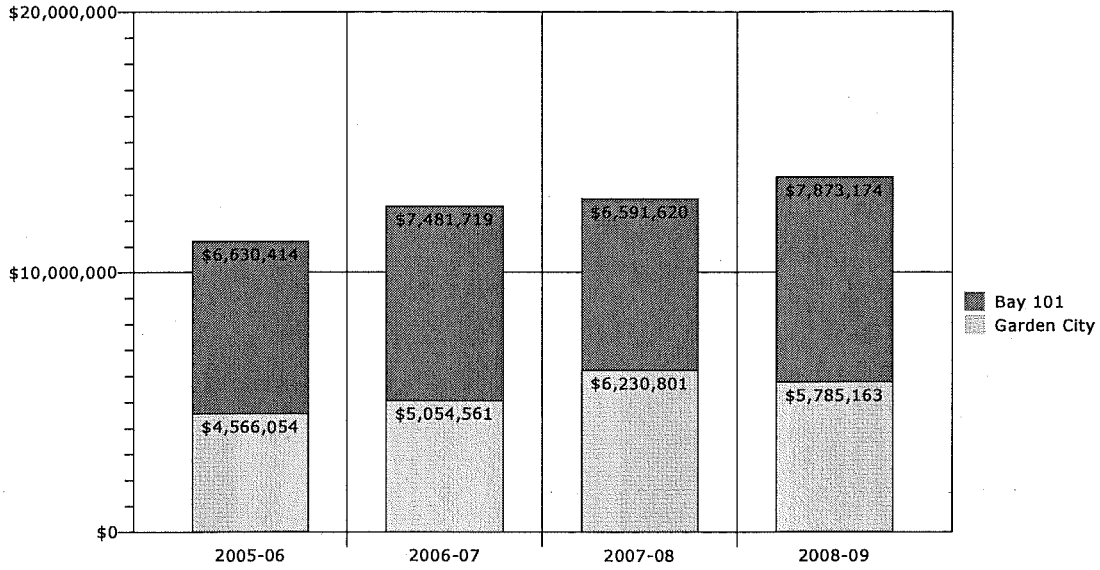
Source: SJPD Fiscal Unit - these figures do not include Citywide overhead costs, City Attorney's Office salary costs, and encumbrances of $161,655 from Non-Personal Services.

Cardroom Taxes, Fees, and Contributions

Currently the City charges the cardrooms a monthly 13 percent tax on their gross revenues. For 2008-09, the tax revenue generated from the cardrooms was about $13.6 million. The cardrooms are required to report gross receipts on a monthly basis to the City. Exhibit 3 illustrates the cardroom tax revenue for the past four years.

[4] FY 2009-10 adopted budget amount does not include Citywide overhead costs or City Attorney's fees as shown on page 23.

Exhibit 3: San José Cardroom Tax Revenue from 2005-06 to 2008-09



Source: The City's Financial Management System.

The cardrooms also pay for the cost of regulation through a per table fee. Based on the current number of cardroom tables in the City (80), the table fee is $25,527 per table, or about $1 million per cardroom.

In addition, based on a March 2009 settlement with the City, the cardrooms are required to make annual charitable contributions of $500,000 per fiscal year for three years to charities identified by the City through the City Council's Healthy Neighborhoods Committee (or in such other fashion specified by Council).

History of Gaming Regulation in California[5]

Prior to 1998, regulation of cardrooms was left exclusively to local jurisdictions, which had full authority under their police powers to prohibit or regulate gambling in the interest of the public health, safety, and general welfare. In 1984, the Legislature enacted the "Gaming Registration Act", which required owners of cardrooms to register with the Attorney General as a pre-condition for operating a cardroom in California. However, the scope of the Attorney General's authority was extremely limited and funding was inadequate.

[5] Source: Wear Simmons Ph.D., Charlene, *Gambling in the Golden State - 1998 Forward*, California Research Bureau, May 2006 and the City Attorney's Office.

California Gambling Control Act

In late 1997, recognizing the need for broader oversight of California's gambling industry, the Legislature enacted the Gambling Control Act (Act)[6] – a comprehensive statute intended to regulate cardrooms across the State. It established a concurrent State regulatory jurisdiction with local governments over cardrooms and created uniform Statewide minimum regulatory standards. The Act requires the local jurisdiction to have an ordinance in place that authorizes the cardroom(s) to operate in the local jurisdiction. The Act expressly created two levels of regulatory jurisdiction over cardroom gambling. Although the Gambling Control Act created uniform Statewide **minimum** regulatory standards, it allowed local jurisdictions to adopt more stringent standards.

The Act created the Bureau of Gambling Control in the Department of Justice (Bureau). It also created the California Gambling Control Commission (Commission), an independent agency with quasi-judicial powers and five members appointed by the Governor. The Commission is the decision making body, while the Bureau is the investigatory body that makes recommendations to the Commission on issues such as whether the Commission ought to grant an applicant a license to operate a cardroom. These bodies are the regulating authorities at the State level and, like the City, license key employees and owners and issue work permits to the cardroom employees.

History of Cardroom Regulation in San José[7]

San José has been regulating cardrooms for many years. Prior to 1999, cardroom oversight and regulation was less rigorous than the City's current regulation under Title 16. According to the City Attorney's Office and the SJPD, the current regulatory environment is in part a result of a history of crime and corruption at the San Jose cardrooms. For example, in 1987, a criminal grand jury handed down an indictment of one of the City's cardrooms, including all of its stockholders, and officers and employees on a host of criminal charges, including conspiracy to defraud their landlord, tax evasion, contribution laundering and skimming. In February 1993, all the stockholders of this cardroom and a host of employees pled to various felony and misdemeanor charges.

In 2000, a 168 count indictment was brought by a grand jury charging 55 defendants with felonies associated with activities at both San Jose cardrooms. The charges included loan sharking, extortion, witness intimidation, sale of crack cocaine, felonious assault, credit card fraud by mail theft, counterfeit check passing, forgery, and perjury. Various defendants pleaded guilty or no contest to various felonies and misdemeanor charges.

[6] The California Gambling Control Act (Chapter 867, statutes of 1997) became effective on January 1, 1998.

[7] Information provided by the City Attorney's Office.

Further, according to staff, concerns about the social effects of gambling and questions raised about the adequacy of the City's regulation of cardrooms led the City in 1998 to hire a consulting firm to review and recommend changes to the City's regulatory approach of controlling cardroom operations. The consultant – Spectrum Gaming Group – completed its review in August 1998. Its analysis focused on how to ensure that the cardrooms operate effectively and in a manner which is socially responsible. The report recommended a variety of regulatory, law enforcement, and cardroom operational enhancements.

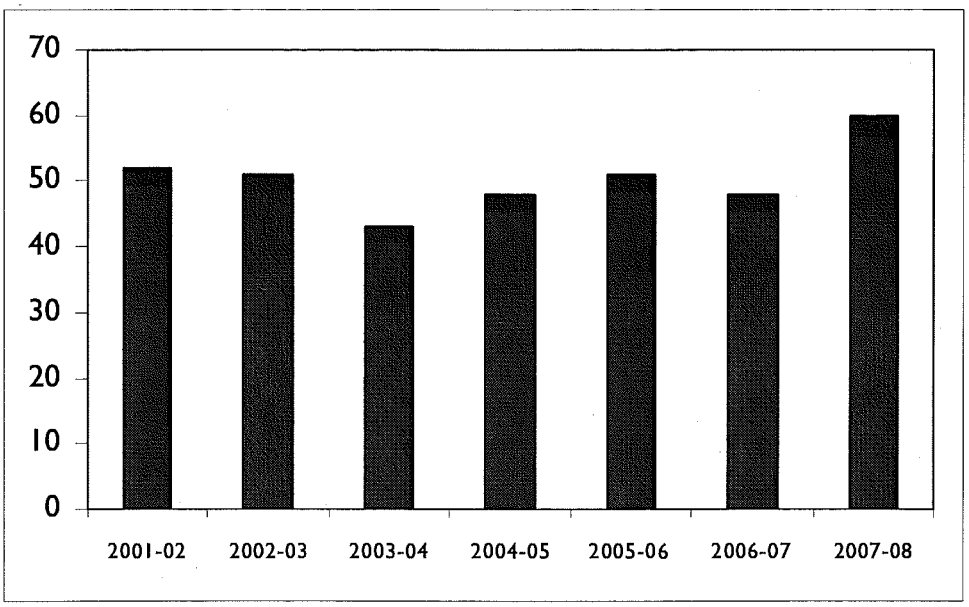
In 1999, the San José City Council adopted Title 16 of the San José Municipal Code, which contained the minimum requirements dictated by the Gambling Control Act, as well as changes recommended by Spectrum Gaming Group, and other provisions directed by Council and the Administration.

In 2002, the City hired a Gaming Administrator with experience in regulation of casinos in Nevada and other state jurisdictions to enforce Title 16. The Gaming Administrator has worked on various aspects of promulgating regulations and developing a comprehensive licensing and work permitting process since that time. For a description of the responsibilities of the Gaming Administrator, see Appendix B.

Crime Statistics

The SJPD reports on all crimes occurring at the cardrooms in an annual report to the City Council. In June of 1996, the City Council amended the cardroom ordinance, Chapter 6.22, to require an annual report to the City Council evaluating the impact of cardroom gambling on crime in the San Jose metropolitan area. Exhibit 4 shows the total arrests at the two cardrooms from 2001-02 to 2007-08.

Exhibit 4: Total Arrests Made at Both Cardrooms from 2001-02 to 2007-08



Source: Auditor summary of total arrests at cardrooms from the *"Annual review of the impact of cardroom gambling on crime in the City of San José."* For more information see http://www.sanjoseca.gov/clerk/Agenda/20090512/20090512_0801.pdf

We should note that the other California jurisdictions that we surveyed either do not report on crimes occurring at the cardrooms in their jurisdictions or cardroom crime information was not readily available.

Audit Scope and Methodology

In October 2009, the Mayor and City Council requested the Office of the City Auditor incorporate into the pending audit of the City's licensing and permitting of cardroom owners and employees:

- A comparison of the scope and costs of background investigations for licenses for owners, key employees, and third-party proposition players with the State and other California jurisdictions with at least 20 tables,
- A comparison of the cost of oversight with the State and other California jurisdictions with at least 20 tables, and
- An evaluation whether we have the appropriate levels of staffing of police officers and auditors for the work that needs to be done.

In order to address these questions, we performed the following:

1. To assess the City's scope and cost of background investigations, we interviewed and walked through the license background investigation process with staff from the DGC. We also reviewed a sample of the

DGC's background investigation files.[8] In addition, we interviewed staff from the California Department of Justice Bureau of Gambling Control, and received responses to written questions from the Nevada Gaming Control Board at the State of Nevada and four California jurisdictions with cardrooms having 40 or more tables (including, Bell Gardens, Colma, Emeryville and San Bruno). We compared table fees among the above jurisdictions, and reviewed jurisdictions' municipal codes and ordinances as they relate to cardroom regulation.[9]

2. To evaluate the efficiency and effectiveness of the City's cardroom work permits process we interviewed staff from the DGC and Permits Unit of the San José Police Department, who provided us a walkthrough of the permitting process. We also reviewed work permit workload databases for the DGC and Permits Unit, and reviewed a sample of work permit application files.[10] Finally, we surveyed and interviewed the above mentioned jurisdictions regarding their cardroom work permitting process.

3. To review the costs associated with the City's cardroom regulatory oversight function, we examined various City documents and reports including, but not limited to: Financial Management System (FMS) expenditure reports, Adopted Table Fees report, and PeopleSoft compensation and benefits reports. Further, we also interviewed staff from the San José Police Department Fiscal Unit, the City Manager's Budget Office, the Department of Finance, and the City Attorney's Office.

In addition, we interviewed key staff from Bay 101 and Garden City cardrooms, the City Attorney's Office, the Office of the City Manager, and the Department of Finance. We reviewed Title 16 of the San José Municipal Code, and relevant sections of the State of California Business and Professions Code. We reviewed a consultant report performed for the City of San José: *Results of a Survey and Review of Cardroom Operations*, and a California Research Bureau Report *Gambling in the Golden State - 1998 Forward*. Lastly, we reviewed various court settlements between the City of San José and the cardrooms.

The scope of the audit included calendar years 2001 through 2009.

[8] We reviewed a total of 8 of 31 (25%) license background investigation files that were either completed or in progress; 1 was a license renewal file, 3 files were work in progress, and 4 files were completed.

[9] We should note that we did not compare the scope and cost of background investigations for third party proposition players because this function is currently not being performed by the DGC.

[10] To assess the accuracy and reliability of work permit data, we reviewed a total of 4 cardroom work permit files from the DGC and reconciled information from the files to the work permit databases.

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Finding I The City's Processing of Key Employee and Owner Licensing Is Overly Rigorous and Should be Redesigned

State law requires that every cardroom owner[11] or key employee[12] of a gambling establishment obtain and maintain a valid State gambling license. The Bureau of Gambling Control investigates the qualifications of individuals who apply for State gambling licenses to determine whether they are suitable and to ensure that gambling is conducted honestly, competitively, and free from criminal and corruptive elements. Title 16 of the San José Municipal Code requires that cardroom owners or employees obtain a valid City of San José -issued gaming license. We found that:

- Both the California Bureau of Gambling Control and the City's DGC investigate the qualifications of individuals who desire to be owners or key employees in the City's cardrooms;
- The cost of regulating cardrooms and licensing in San José is higher than all but one California jurisdiction that we surveyed;
- The DGC has a significant backlog of key employee license investigations which it has not started nor completed and as a result has issued various temporary licenses;
- Title 16 provides broad latitude on determining the scope of its license investigations, however, the guideline is to complete license investigations in 180 days;
- Redesigning its licensing work would allow the DGC to even further focus on its other regulatory activities;
- The DGC should track costs of each licensing review; and
- The City needs to ensure it uses actual costs when calculating table fees.

In our opinion, the license backlog cannot be addressed by simply adding more staff. The DGC needs to take advantage of opportunities to become a more efficient regulator. First, the City should amend Title 16 to require and rely solely on the State's key employee license for issuing a San José

[11] Per §16.02.460 of the San José Municipal Code, *"Owner" means every person who owns an interest in any Cardroom or Cardroom Permittee.*

[12] Per §16.02.420 of the San José Municipal Code, *"Key Employee" means any person employed in the operation of a Cardroom in a supervisory capacity who is authorized or empowered to make discretionary decisions with regard to Gambling operations, including, without limitation, shift managers, credit executives, cashier operations supervisors, Gambling operation managers and assistants, managers or supervisors of security personnel, surveillance managers or supervisors, or any other person designated as a Key Employee by the Administrator because the Administrator believes the person has the power to exercise a significant influence over the gaming operation of the Cardroom Permittee or for other reasons consistent with the public interest, and the policies of this Title.*

key employee license thereby reducing the DGC's workload while preserving the City's ability to impose limitations and conditions on these licenses including the ability to retract the license based on the key employee's violations of Title 16. Second, the City should abide by the Title 16 guideline that license investigations should be completed in 180 days and develop clear written guidelines for when investigations can extend beyond 180 days. Furthermore, to better manage its pending license investigations the City should redesign its background investigations to a) better provide clearer guidance on the desired scope of the licensing process, b) be more limited in scope and c) track and report the status and cost of these pending and incomplete license investigations through the Annual Report to the City Council. Finally, the City should liquidate the two encumbrances in the DGC's fund and use the funds to offset DGC costs.

The California Bureau of Gambling Control Investigates the Qualifications of Individuals Who Desire to Be Owners or Key Employees in the City's Cardrooms

Title 16 requires each cardroom owner and key employee to obtain a license from the DGC. In addition to being licensed by the City, each owner and key employee must also obtain a license from the California Gambling Control Commission. The California Bureau of Gambling Control within the California Attorney General's Office (Bureau) conducts the background investigation of each applicant[13]. The Bureau's investigation of the background of each applicant is similar to the investigation performed by the City's DGC in that the Bureau investigates the personal, financial, and criminal backgrounds of each applicant. The primary difference between the City and the State is that the City reviews more years of financial history than the Bureau.[14]

In other words, the City and the Bureau are doing the background investigations on the same applicants. This offers an opportunity for the City to reach an agreement with the Bureau in which the City's DGC splits the responsibility of licensing of San José applicants with the California Bureau of Gambling Control. One way to split the work between the Bureau and the DGC would be for the DGC to do the background investigation and issue licenses to cardroom owners, but for key

[13] The Gambling Control Act, (Business & Professions Code section 19800 et seq., and California Code of Regulations, Title 11 Division 3), requires that every person employed in the operation of a gambling establishment in a supervisory capacity or empowered to make discretionary decisions that regulate gambling operations apply for a license as a Key Employee. This includes, but is not limited to, gambling operation managers and assistant managers, managers or supervisors of security employees, pit bosses, shift bosses, credit executives, and cashier operations supervisors. Please refer to the Bureau of Gambling Control website for additional information http://ag.ca.gov/gambling/forms/forms_keyEmployee.php.

[14] Once the Bureau completes its investigation it makes a recommendation to the California Gambling Control Commission, which ultimately grants or denies the applicant a license.

employees, the DGC would rely solely on the Bureau's process for issuing key employee licenses.

The Cost of Regulating Cardrooms in San José Is Higher than All But One California Jurisdiction That We Surveyed

San José spends more than four times what the State spends in staff hours to complete one background investigation of an application from a cardroom owner or key employee. Although, the DGC does not typically track the number of hours that it spends on each background investigation, the DGC did track the hours that it spent on four owner background investigations in 2007. On average, the DGC spent 550 staff hours per application. According to the Gaming Administrator, the amount of time spent on owner and key employee applicants is consistent and similar. We should note that the hours tracked do not include time that the Gaming Administrator spent reviewing these files. Based on this, our interviews, and reviews of DGC files, we believe the 550-hour estimate is conservative. In contrast, the California Bureau of Gambling Control spends an average of about 100 hours of staff time to do background investigations of license applications for owners and about 30 hours of staff time for key employees. Exhibit 5 shows the difference in State and City costs.

Exhibit 5: Comparison of the Estimated Cost of Background Investigations by San José and State of California

	Estimated Cost of Background Investigation for Cardroom License Applicants	
	Owners	Key Employees
San José*	$35,615	$35,615
State of California**	$7,500	$2,400

*Source: Division of Gaming Control (only includes direct costs; does not include time spent by the Gaming Administrator, City Attorney fees or city-wide overhead).

**Source: Information on the cost in staff time of background investigations was provided by the Assistant Chief of the Licensing Section, Department of Justice Bureau of Gambling Control. The Auditor's Office did not audit the information provided by the State. Amounts only include direct costs.

The DGC's Background Investigations Are More Rigorous than the State

One factor that contributes to San José's comparatively high costs is that no other jurisdiction in California that we surveyed is as rigorous in conducting background investigations of applicants for owner and key employee licenses. Specifically, the DGC does an in-depth review of the personal, financial, and criminal history of applicants to ensure that they

are suitable to own or be employed in one of San José's cardrooms, and to ensure that unsavory characters, criminals, or otherwise unqualified applicants are not associated with legalized gaming operations in San José.

San José spends more time on its background investigations because it delves deeper into each applicant's past than does the State. For example, in the eight background files we reviewed, San José collected ten years of most applicants' financial history, whereas the State typically asks for only three years of financial history. San José's financial history review includes analyses of up to 10 years of tax returns, bank statements, bank deposit slips, cancelled checks, auto and home insurance policies, home ownership documents including mortgage documents, investment accounts, and gaming credit checks. For example, applicants may be required to submit cancelled checks for the last 10 years and may be required to explain the purpose of any check, including one instance requiring an explanation for a cancelled check of $501.97.[15]

In addition, San José does a more in-depth review of an applicant's personal life than does the Bureau. In one of the files we reviewed we noted that staff from the DGC had actually visited the applicant's home and, with the permission of the applicant, had taken photographs of the inside and outside of the applicant's home.

Another difference between the City and the State is that the City interviews applicants' neighbors about the life-style of the applicant whereas the State typically does not. The Police Officers assigned to DGC estimate that they spend about 10 percent of their time conducting criminal background investigations which include interviewing an applicants neighbors and in some instances may even travel out of state to look at previous homes of the applicants.

Spending this much time on background investigations appears to be more than was initially recommended. The 1998 report by Spectrum Gaming Group that led to the creation of the DGC, recognized the value of having the DGC conduct background investigations on applicants for owner and key employee licenses. The consultants projected that the DGC would spend an average of 200 hours doing each background investigation. However, as noted above, the DGC is spending 550 hours on each background investigation (based on a conservative estimate), or more than twice what the consultants initially projected and more than four times what the State spends on its background investigations.

The DGC has a history of being unable to keep up with its licensing workload. According to the DGC, it inherited a license backlog of 37 applications when the Gaming Administrator arrived in 2002. Since 2002, the DGC has completed a total of 19 owner and key employee

[15] According to DGC senior staff, generally, the threshold for cancelled checks for key employees is $1,000; and for owners is $5,000. However, this threshold may be lowered if a more detailed review is needed.

applications (see Exhibit 7). However, as of March 2010, 49 cardroom owners' and key employees' license applications are still backlogged. Because the DGC has been unable to keep pace, its licensing workload backlog continues to increase, and in place of a regular license the DGC has been granting a temporary license to those applicants whose applications it has not completed. The DGC grants these temporary licenses after conducting a cursory investigation of the applicant's personal, financial, and criminal background.

The City has taken a first step toward making its regulation of cardrooms more efficient. In March 2009, the City changed its format and requirement for license renewals to be more streamlined and timely. Specifically, the DGC streamlined the renewal form and requirements. However, while conducting our audit, we noted that one owner submitted a license renewal application in July 2009 (subsequent to adoption of the streamlined process); yet the license renewal was still pending in February 2010. According to the Gaming Administrator, he has been unable to complete the license renewal because of other regulatory duties.

San José's Regulation of Cardrooms Is More Costly Than Most Other Jurisdictions We Surveyed

We also found that San José's table fees are higher than all but one of the jurisdictions we surveyed. Exhibit 6 below illustrates this difference.

Exhibit 6: Comparison of Table Fees by Cardroom and Jurisdiction FY 2009-10

Name of Cardroom	City	Number of Tables	Annual Table Fee	Annual Total Table Fees
Bay 101	San José	40	$25,527	$1,021,080[16]
Garden City	San José	40	$25,527	$1,021,080[16]
Lucky Chances	Colma	60	$500	$30,000[17]
Artichoke Joe's	San Bruno	38	$39,382	$1,496,516[18]
Oaks Card Club	Emeryville	40	$12,000	$480,000[19]
Bell Gardens Bicycle Club	Bell Gardens	175	None	N/A[20]

Source: Survey responses provided by cardroom jurisdictions and auditor review of the local jurisdiction municipal codes.

[16] As per the San Jose Municipal Code, both cardrooms also pay a 13% tax on gross receipts.

[17] As per the Colma Municipal Code, the cardroom also pays a monthly tax of $287,800 plus 20% of monthly gross revenue over $3,000,000.

[18] San Bruno Municipal Code does not require a tax on gross receipts. Instead, a quarterly table fee is charged. It should be noted that the rates have been adjusted a number of times since 1995, so they do not correlate with the San Bruno Municipal Code.

[19] As per the Emeryville Municipal Code, the cardroom pays a monthly tax of 10% of the monthly gross receipts, or shall pay, monthly, a license tax of $1,000 per table, per month, whichever of these two tax amounts is greater

[20] Per the Bell Gardens Municipal Code, card clubs are not required to pay table fees, instead the cardroom pays a monthly gross revenue license fee of $163,200 plus 13.2% of monthly gross revenue.

As Exhibit 6 shows, San José's two cardrooms pay about $25,000 per table per year, or a total of about $2 million to cover the cost of the City staff that is involved in regulating the operation of the cardrooms.

Part of the reason that San José's costs are higher than other jurisdictions is that San José employs more regulatory staff than any other local jurisdiction that we surveyed. In addition to the Gaming Administrator, San José has six staff devoted exclusively to the regulation of its cardrooms. Other than the California Bureau of Gaming Control, which regulates all 90 of the cardrooms in the State, no other jurisdiction has devoted the number of staff that San José has to regulate its cardrooms. According to the Administration, the City put in place the present regulatory structure in 1999 because of the history of criminal activity that had occurred in the San José cardrooms and the City wanted to ensure that gambling is conducted free of criminal and corruptive elements in the City of San José.

The DGC Has a Significant Backlog of Key Employee License Investigations Which it Has Not Started or Not Completed

The DGC currently has a backlog of 49 applications that have not yet been started or applications that have been started but not completed. Adding to the workload are the renewal investigations that need to be prioritized over the new licenses. Exhibit 7 below shows the current key employee and owner license backlog.

Exhibit 7: Summary of the DGC's License Application Workload From 2002 Through 2010 (as of March 23, 2010)

License Application Status[21]	Bay 101	Garden City	Total
Completed Initial Licenses	7	9	16
Completed Renewals	2	1	3
Completed Applications Subtotal	**9**	**10**	**19**
Pending Applications:			
○ *Work In Progress*	5	7	12
○ *Not Yet Started*	15	22	37
Pending Applications Subtotal	**20**	**29**	**49**[22]
Total	**29**	**39**	**68**

Source: The DGC provided spreadsheets of 'Completely Processed Key Employee & Stockowner Applications' and 'Pending Key Employees & Stockowners Applications.'

[21] May include employees who have been terminated or no longer work at the cardrooms.

[22] Does not include three pending applications, which were withdrawn before being completed.

The 49 pending applications include: 2 owners[23], 43 key employees, and 4 owners seeking to renew their licenses. Title 16 does not allow for owners to operate without a license, however, the 2 owners have been grandfathered in since 1999. According to §16.32.300, *"Every person who was approved by the Chief of Police as the purchaser, transferee, or assignee of stock in a Cardroom Permittee [...] prior to December 23, 1999 shall be granted a Stock Ownership License by the Administrator."*

The remainder of the incomplete and not started license applications are for 43 key employee license applications. According to Title 16 *"the Administrator may issue to an Applicant for a Key Employee License a temporary Key Employee License after the Applicant has submitted a completed application to the Administrator and the required deposit has been paid. The Administrator shall provide an initial decision whether or not to issue a temporary Key Employee License no later than fifteen (15) working days after the Administrator receives a signed application, payment of any required fees or deposit, and the criminal history return from the California Department of Justice."*

We found that most key employees are working in the cardrooms with a temporary license based on these cursory reviews for many years. In a few instances the DGC has yet to begin its investigation of key employee licenses for employees that applied for a key employee license in 2001. These employees continue to work in the cardroom on a temporary or provisional license. On average, the key employee license investigations have been pending for 3 years.[24] Further, 10 of the 49 backlog applications have been either pending or not processed for more than 5 years. In our opinion, letting key employees work in their positions based on a cursory review would increase the risk that persons of unacceptable character could work at these cardrooms for multiple years while the DGC continues its investigations of other employees, were it not for the fact that these employees are also required to be licensed by the State.[25] It should be noted that the State currently has a 12-month backlog and is working on reducing this.

We found that on average the DGC has been able to complete about 2 applications per year. If we extrapolate this to the amount of time it

[23] These two pending owner applications were previously grandfathered. Based on our review, the two pending owner applications had not been renewed by the DGC and background investigations were still pending as of March 23, 2010.

[24] Average is based on 43 pending and not processed key employee applications for both cardrooms. Source documentation used to calculate the average was provided by the DGC.

[25] We should note that we did not compare the scope and cost of background investigations for third party proposition players (also referred to as funding sources) because this function is currently not being performed by the DGC. The City Administration proposal to begin licensing third party proposition players was rescinded October 2009. Pursuant to Business and Professions Code section 19984, except as provided in California Code of Regulations, Title 4, Section 12201 et seq., no person may perform in the capacity of a supervisor, player or "other employee" in the provision of third-party proposition player services without a license issued by the California Gambling Control Commission. Please refer to the Bureau of Gambling Control website for additional information. http://ag.ca.gov/gambling/forms/forms_card.php.

would take to finish all the pending applications, it would take the DGC at least 21 years to fully clear the backlog.

Title 16 Provides Broad Latitude on Determining Investigation Scope; However, the Guideline Is to Complete License Investigations In 180 Days

Title 16 provides the Gaming Administrator with broad authority. Further, with respect to license investigations, there are about 10 disqualifiers defined by Title 16. In addition there are affirmative criteria such as *"A person of good character, honesty, and integrity"* and *"A person who has, in the judgment of the Administrator, the appropriate business ability and experience for the position to which the person is applying."* Title 16 does not limit the kind of investigation that the Gaming Administrator can do to meet the disqualification or affirmative criteria for getting a license. However, the guideline of Title 16 is that these license investigations should be completed in 180 days. Currently, the Gaming Administrator is simply required to provide the applicants with a status report at the end of the 180 days. We should note that all key employee license investigations to date have taken more than 180 days.

Redesigning Its Licensing Work Would Allow the DGC to Focus Even Further on Its Other Regulatory Activities

The DGC estimates that its staff spends 32 percent of their time on permits and licensing and 27 percent of their time regulating the cardrooms, of which 6 percent is spent promulgating regulations and conducting revenue audits. Exhibit 8 provides a summary breakdown of the DGC various work duties and the percent of time spent on each category. See Appendix C for more detail.

Exhibit 8: Breakdown of the DGC Work Duties by Percent as of February 2010

DGC Work Categories	% of Total
Permits and Licensing	32%
Regulation	27%
Administrative / Clerical	24%
Other Functions (Training, Supervision)	17%
Percent of Total DGC Work Time	**100%**

*Source: DGC provided percent of work categories by employee. Totals by categories were computed by the Auditor's Office.

As mentioned above, Title 16 provides the Gaming Administrator with broad authority to regulate cardrooms. The Gaming Administrator is authorized to inspect, examine, remove and impound all documents,

records, books, supplies, and other equipment on the cardroom premises. Further, the Gaming Administrator can visit, investigate, and place expert accountants, technicians, and any other persons that the Gaming Administrator deems necessary in any areas of the cardrooms for purposes of determining compliance with the requirements of Title 16 and State Gambling Law. Finally, the Gaming Administrator may perform such financial and compliance reviews and oversight of each cardroom as the Gaming Administrator feels necessary.

In our opinion, refocusing the DGC's effort from doing detailed and time consuming background investigations of individual employees would address its current license backlog and allow the DGC more time on other regulatory activities and financial reviews of cardrooms.

Finally, in our opinion, the license backlog cannot be addressed by simply adding more staff. The DGC needs to take advantage of opportunities to become a more efficient regulator. In addition, as stated earlier, the Auditor's Office has previously recommended that the SJPD consider civilianizing the four sworn positions in the DGC and replacing them with four civilians who could be specially trained in this type of work.[26]

We recommend that the City Administration:

Recommendation #1

Retain the City's licensing of cardroom owners, and propose amendments to Title 16 to require and rely solely on the State's key employee license for issuing a San Jose key employee license thereby reducing the DGC's workload while preserving the City's ability to impose limitations and conditions on these licenses including the ability to retract the license based on the key employee's violations of Title 16. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)

Recommendation #2

Abide by the Title 16 guideline that license investigations should be completed within 180 days and develop clear written guidelines for when investigations can extend beyond 180 days. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)

[26] The DGC's four sworn positions were part of the 88 positions recommended for civilianization in the January 2010 *"Audit of Civilianization Opportunities in the San Jose Police Department"*.

We recommend that the City Administration:

Recommendation #3

To better manage its backlog of pending license investigations, redesign its background investigations to: a) provide clearer guidance on the desired scope of the DGC licensing process, b) be more limited in scope, and c) track and report the status and cost of these pending and incomplete license investigations through the Annual Report to the City Council. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)

The DGC Should Track Its Costs of Each Licensing Review

Even though the DGC tracks the total cost of regulation, it is unable to provide a detailed breakdown of the costs and time spent on the background of each licensing application. In contrast, the Assistant Bureau Chief at the California Bureau of Gambling Control confirmed that the Bureau tracks the cost of the staff time that it takes to complete licensing reviews by license application. Further, at the end of each review, the applicant is provided a detailed breakdown of these costs. The license applicant is responsible for reimbursing the Bureau any amounts that exceed the initial background deposit paid by the applicant, and the Bureau is responsible for returning any unused portions of the background deposit to the applicant. In our opinion, this policy not only provides applicants with information about what they are paying for, but also ensures transparency in regulation.

According to the Administration, a web-based time sheet management portal was purchased in 2009 in connection with the anticipated restructuring of the DGC (a proposal to split the DGC into a Regulation Unit and Work Permit/Licensing Unit that was later withdrawn). The use of this time sheet system would track the time that DGC staff has expended on each and every investigation and the applicant will be billed based on actual cost recovery. However, the anticipated restructuring has not materialized and the web-based system is on stand-by.

Therefore, we recommend that the City Administration:

Recommendation #4

Implement procedures to track time and costs of each licensing review, provide an itemized accounting to each applicant at the end of each review, and include the per applicant cost in the Annual Report to City Council. (Priority 2)

The City Needs to Ensure That It Uses Actual Costs When Calculating Table Fees

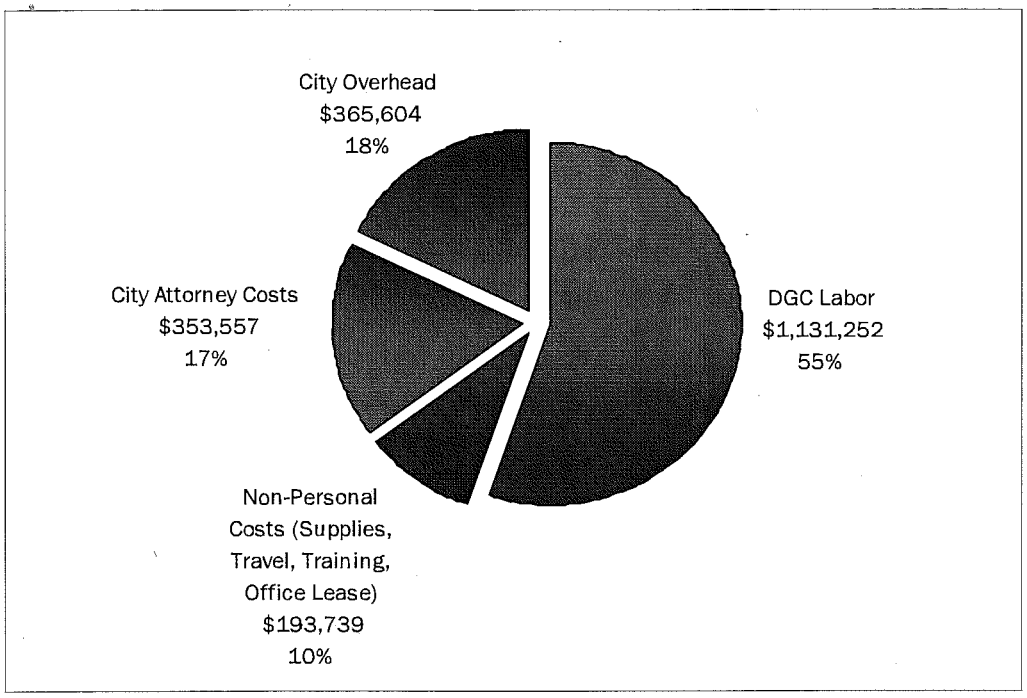
The SJPD's Fiscal Unit and the Budget Office work together in putting together the DGC's costs annually, which are then used to calculate the cardroom table fees.[27] Table fees are calculated by using the total cost of regulation and dividing by the number of tables. Having an accurate calculation of these costs is key to determining the per table fee. Each of the two cardrooms pays this annual per table fee to the City to cover the City's cost of regulation. These costs are used to calculate the annual table fee charged to the two cardrooms, as approved in the Annual Adopted Fees and Charges Report.

The City's total cardroom regulation costs for fiscal year 2009-10 were estimated at $2,042,152. [28] Divided by 80 tables, this translates to a per table fee of $25,527. The fee includes personal and non-personal costs for the DGC, the cost of the DGC's office lease, the City Attorney's costs, and Citywide overhead. Exhibit 9 shows the breakdown of the City's estimated cost of cardroom regulation for FY 2009-10.

[27] §16.30.060(B) of the San José Municipal Code states that the card table fee shall be paid to the City of San José in quarterly installments.

[28] Per the Annual Adopted Fees and Charges Report, each cardroom is scheduled to pay $1,021,076 for fiscal year 2009-10.

Exhibit 9: Estimated Cardroom Regulation Costs FY 2009-10



Source: Auditor prepared based on data provided by SJPD-Fiscal Unit. It should also be noted total estimated regulation costs are $2,044,152 which include $2,000 for 2 cardroom business licenses at $1,000 each.

The City Needs Improvements in Calculating the Table Fees

We found that improvements are needed in how the City calculates its table fees. During the course of our review, we identified a fund balance in the DGC's fund in the amount of $161,655. We confirmed that the fund balance was a result of two administrative encumbrances. According to the City's Department of Finance, these administrative encumbrances were created to account for the fund balance that was not spent by the DGC in FY 2002-03. These encumbrances can be liquidated at anytime by the SJPD, but must be used for purposes of the DGC with approval from the City's Budget Office. Based on our recalculation of DGC costs, there could be a one-time liquidation of the $161,655 encumbrance, resulting in a one-time table fee reduction of about $2,000 per table to a table fee of $23,506.

In addition, we found that the City used top step salaries in some instances and not actual costs for calculating personnel costs. We also found a minor error in the calculation of overhead. However, the total amount of these two errors was less than $10,000.

We recommend that the City Administration:

Recommendation #5

Liquidate the two encumbrances in the DGC's fund and use the funds to offset DGC costs. (Priority 2)

Finding II The City's Processing of Work Permits Has Been Slow

The DGC's processing of work permits has been slow and needs to be improved. We found that:

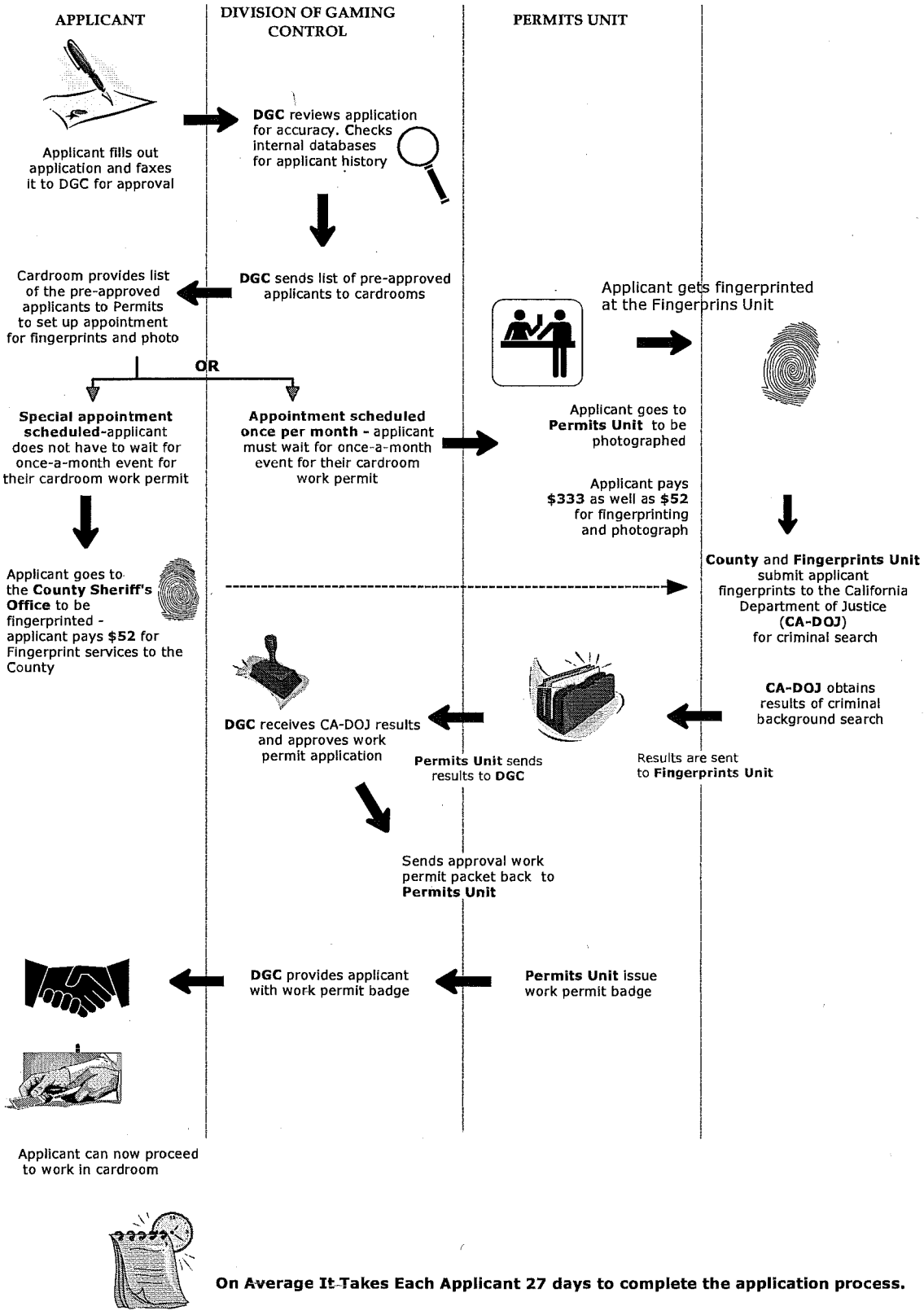
- Title 16 of the San José Municipal Code requires all cardroom employees to have a work permit;
- The current work permitting process oftentimes takes more than one month to issue;
- The DGC recently made attempts to streamline the permitting process;
- The DGC should review and determine whether it can do work permits in-house, and;
- Other California jurisdictions rely on the State to process work permits.

In our opinion, the Administration should either propose revisions to Title 16 to discontinue the City's permitting function and accept State-issued portable gaming work permits, or process work permits within the DGC. If the Administration chooses to process work permits within the DGC we also recommend that a) the DGC continue to streamline and develop a work permitting approval and renewal process that strictly abides by the Title 16 guideline to issue work permits within 20 working days, and b) that the Administration analyze the cost recovery status of work permit fees.

Title 16 of the San José Municipal Code Requires All Cardroom Floor Employees to Have a Work Permit

According to Section 16.40 of the Municipal Code, every employee of the cardroom who is a gambling enterprise employee and is not a key employee shall apply for and obtain a work permit prior to beginning employment. Title 16 prescribes 15 conditions for denial of a work permit. These conditions include any violations of Title 16, supplying misleading or untrue information to the Gaming Administrator, conviction of any crime punishable as a felony, or commitment of a dishonest, fraudulent, or deceitful act. Title 16 also requires the Gaming Administrator to provide a written decision regarding the applicant's status within 20 working days. Exhibit 10 illustrates the current work permit application process.

Exhibit 10: Flow Chart of San José's Current Cardroom Work Permit Process



Source: Auditor compiled based on information provided by DGC.

As the exhibit above shows, an applicant has to go through multiple steps and through various governmental agencies and departments to get a work permit. Initially, the applicant is pre-screened by the DGC. The DGC established the pre-screening process as an effort to make improvements to its process. This was established for two reasons: 1) to avoid delays in those applications in which the applicant is seeking a permit that enables them to work in two different jobs[29] in the cardrooms and 2) undesirable applicants do not have to go through an entire permitting process before finding out that their application for the permit was unsuitable. Generally an applicant faxes a completed application to the DGC for a pre-screening.

During the pre-screening process a Police Officer at the DGC checks the application for accuracy and also checks its internal databases and records to check whether the applicant has a prior history with the City.

Once the pre-screening is completed the application is faxed back to the cardrooms. The cardrooms then send this pre-screened employee list to the Permits Unit at the SJPD to schedule an appointment. The Permits Unit schedules appointments once a month for about 40-50 cardroom applicants. The applicant pays a $333 fee and an additional $52 for fingerprinting which is done at the Fingerprints Unit of the SJPD during these monthly appointments. The Fingerprints Unit electronically sends the fingerprints to the Department of Justice (DOJ) at the State for review of the applicant's criminal background. According to the DGC, the entire process from an applicant submitting his/her application to receiving a work permit can take from six to eight weeks. With respect to renewals, the applicants do not need to go through the entire application process but they must submit a renewal application. The DGC will be automatically informed by the DOJ if there has been a change in the applicant's criminal history from the applicant's initial application.

The Current Work Permitting Process Oftentimes Takes More Than One Month to Issue

As mentioned above, the Gaming Administrator is responsible for approving or denying a gaming work permit. Title 16 requires a work permit to be either approved or denied within 20 working days of an applicant submitting their application. We found that the DGC frequently does not meet its 20-day target. There are various reasons for this delay. First, the SJPD Permits Unit only schedules appointments for work permit applicants one day a month. This automatically builds delay into the process from the applicant's point of view. There is also the initial pre-screening process, after which the SJPD's Permits Unit

[29] For those applications in which the applicant is seeking to be permitted for two different jobs, the DGC must first ensure that the two jobs are not incompatible. Dual work permits are allowed under Title 16, but the two employment categories must be compatible under the City's Minimum Internal Control Standards. So, the DGC staff review the two jobs to ensure that the duties are compatible.

has to send each applicant's fingerprints to the State Department of Justice to determine if the applicant has a criminal history that would make them unsuitable to work in a cardroom.

We found that for 2009, with respect to new applications, it took an applicant an average of 27 working days (or 36 calendar days) to get their permit.[30] Further, even for renewals where the process is shorter, we found that it took an applicant an average of 41 working days to renew their work permit.[31] Approximately 60 percent of license renewals took between 40 and 60 working days to be issued. In our opinion, the current work permitting process is burdensome, not customer oriented, and needs improvement.

The DGC Recently Made Attempts to Streamline the Permitting Process

The DGC recognizes the need for improvement in the work permits section. In April 2009, in an effort to speed up its work permitting process, the DGC spent about $70,000 on the equipment necessary to do the entire permitting process in its own offices. This new process allowed the applicants to submit their applications on any business day as contrasted to the one day a month under the existing arrangement. This streamlined process also saved steps for the permitee, because the permitee was no longer required to travel to the SJPD's Permits Unit to formally file an application. The new equipment allowed the DGC to take applicant photographs, print work permits, and do fingerprints and transmit them to the DOJ for a criminal history review. The DGC used this process for about three weeks. In these three weeks, the DGC processed 30 work permits and issued each permit in an average of 11 working days.[32] However, according to the DGC because its work is funded through card table fees, the DGC was told that it could not collect additional work permit fees, and the process was transferred back to the SJPD's Permits Unit. We should note that one Police Officer within the DGC still does all the background investigations and pre-screening for the work permit applicants even though the fee for this service is being paid to the Permits Unit separately within the SJPD. Since October 2009, the DGC has not used the purchased equipment and has not done any in-house permits.

The DGC Should Review and Determine Whether it Can Do Work Permits In-House

As mentioned above, according to the DGC in April 2009, it developed a "One Stop Permit" service delivery approach. This significantly eliminated the work

[30] The Permits Unit issued a total of 185 new cardroom work permits from calendar year 2009 through February 4, 2010.

[31] The Permits Unit issued a total of 204 cardroom work permit renewals from calendar year 2009 through February 4, 2010.

[32] From a total of 30 work permits applications processed, 27 work permits were issued, and 3 work permit applications were withdrawn by the applicants.

permit backlog by July 2009. Even though this approach proved successful in providing good customer service to permittees, the DGC had to freeze this operation due to the methodology of how permit fees were being assessed. In our opinion, in order to improve its customer service, reduce the number of departments an applicant has to go to, and expedite permit issuance, the SJPD should explore transferring this function back to the DGC. In essence the DGC would have a separate work permits unit within the DGC with the sole purpose of processing and expediting work permits. Finally, shifting the cardroom work permit function to this new unit in the DGC from the SJPD's existing Permits Unit will allow the existing Permits Unit staff to increase services to other customers.

Other California Jurisdictions Rely on the State to Process Work Permits

The Gambling Control Act requires that all individuals who are employed as gambling enterprise employees hold a valid work permit. The application for a work permit is made to the California Gambling Control Commission when the local licensing authority does not require a work permit. In other words, if a work permit is issued by the City, the State would not require the employee to get another work permit from the State to work in a San José cardroom.[33] On the other hand, the City requires all prospective employees at San José cardrooms to obtain a City-issued gaming work permit, even if they already have a current State issued- work permit. The State application fee is $250 and the applicant is also required to pay the required Live Scan (fingerprinting) fee to a provider that does that service. According to the Assistant Chief of the Licensing Section, Department of Justice Bureau of Gambling Control, the State's work permit is portable to all those jurisdictions for which the State issues work permits. The City's work permit is not portable.

Therefore, we recommend that the City Administration:

Recommendation #6

1. **Propose revisions to Title 16 to discontinue the City's permitting function and accept State-issued portable gaming work permits, or**
2. **Process work permits within the DGC.**

If the Administration chooses to process work permits within the DGC we also recommend that: a) the DGC continue to streamline and develop a work permitting approval and renewal process that strictly abides by the Title 16 guideline to issue work permits within 20 working days, and b) the Administration analyze the cost recovery status of work permit fees. (Priority 3)

[33] In contrast, the State and the City both issue key employee and stockowner licenses.

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APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Policy Manual (6.1.2) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class[1]	Description	Implementation Category	Implementation Action[3]
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring.[2]	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists.[2]	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

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1 The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

2 For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of $50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of $100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.

3 The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.

APPENDIX B

OTHER DUTIES

The DGC is charged with ensuring compliance with Title 16. In order to do so the DGC has various responsibilities in addition to the ones described in Finding I and II related to licensing and permitting. According to the Gaming Administrator, and the City Attorney's Office other duties include:

- Promulgating regulations;
- Issuing provisional rules;
- Ensuring compliance with the Minimum Internal Control Standards (MICS) and accounting regulations;
- Issuing regulatory fines for violations of Title 16;
- Enforcing the Observed Patron-20 hour presence restriction;
- Matching the daily count of table fees to the monthly tax return submitted by the cardrooms to the Finance Department;
- Periodic count room observation;
- Compliance reviews of cardroom cage and accounting operations;
- Monitoring daily gaming revenues;
- Preparing statistical records to compare to the cardroom monthly tax statements;
- Administering the requirement that the cardrooms have an independent CPA do an annual audit of the cardroom;
- Regulating the games played and enforcing the restrictions imposed by Title 16 on the types of games being played at the cardrooms;
- Vendor approval;
- Ensuring compliance with the Gambling Control Act and California Penal Code;
- Investigating the qualifications of applicants;
- Prescribing all forms to be used for the investigations of the qualifications of applicants;
- Administrative investigations;
- Attending administrative hearings;
- Issuing minor citations (done by sworn staff);
- Developing sources; and
- Following-up on complaints.

In March 2009, Title 16 was amended to add new responsibilities to the Gaming Administrator such as licensing of third-party proposition players.[1]

[1] Compliance with changes to Title 16 became effective in May 2009.

APPENDIX C
Allocation of Work Duties

In February 2010, the DGC provided estimates of work categories by employee as follows:

Work Categories	Gaming Administrator	Supervising Auditor	Sergeant	Police Officer	Police Officer	Police Officer	Staff Technician	Auditor Calculated % To Total[1]
Promulgating Regulation	5%	0%	5%	1%	1%	1%	0%	**2%**
Financial Background	20%	75%	0%	0%	0%	0%	0%	**14%**
Criminal Background	0%	0%	5%	10%	15%	15%	0%	**6%**
Compliance Checks/ Incident Reporting/ Investigations/ Report Writing	20%	2%	10%	0%	55%	55%	2%	**21%**
Revenue Auditing	2%	1%	0%	0%	0%	0%	28%	**4%**
Work Permits	1%	0%	5%	70%	2%	2%	5%	**12%**
Administrative/ Clerical	0%	5%	0%	0%	0%	0%	10%	**2%**
Develop & Maintain Procedural Manuals	0%	0%	0%	0%	0%	0%	30%	**4%**
Develop & Maintain Databases	0%	3%	0%	0%	10%	10%	20%	**6%**
Supervision	15%	10%	45%	0%	0%	0%	0%	**10%**
Training	0%	1%	10%	10%	10%	10%	5%	**7%**
Source Development/ Management	2%	0%	5%	0%	0%	0%	0%	**1%**
Charitable Gambling	0%	0%	0%	1%	0%	0%	0%	**0.1%**
Administrative and/or Regulatory Action	5%	0%	5%	0%	2%	2%	n/a	**2%**
Coordination with the CAO[2]	10%	0%	5%	0%	0%	0%	0%	**2%**
Inter/Intra Departmental Assistance	20%	3%	5%	5%	5%	5%	n/a	**6%**
Total	100%	100%	100%	100%	100%	100%	100%	**100%**

Source: Table was provided by the DGC.

[1] Using the percentages provided by the DGC, the Auditor's Office summarized the work duty estimates to determine the totals for the DGC as a whole.
[2] City Attorney's Office.