

**Senate Community, Economic and Recreational Development Committee
Informational meeting
Gregory C. Fajt, Secretary
Department of Revenue
January 30, 2007**

Since today's hearing was prompted by the Department of Revenue's pending transfers of funds from the Section 1401 accounts maintained by the operators of licensed gaming facilities, I will begin with a brief explanation of the accounts and the legislative authority for them.

Section 1401 accounts were created by the General Assembly under Act 71 of 2004. The accounts, by statute, are intended to provide an ongoing source of funding to regulate and police slots gaming in Pennsylvania. Each gaming facility licensee is required to deposit \$5 million into its Section 1401 account two days before the facility opens. By statute, money transferred from a 1401 account by the Department must be replenished by the licensee on a weekly basis.

Under Section 1402 of the Act, the Revenue Department is tasked with determining the "costs, expenses or payments" to be transferred from each Section 1401 account to the Gaming Control Board, Pennsylvania State Police, Department of Revenue and Attorney General's Office. Since the legislative appropriation that funded the start-up costs of gaming regulation is now almost exhausted, the Department will this week begin transfers from Section 1401 accounts as required under the Act.

As Chairman Decker noted, developing a procedure to withdraw funds from Section 1401 accounts was complicated by the

fact that, as of today, only three of the accounts exist. The Act did not anticipate that gaming facilities would open in phases. The currently open gaming licensees have maintained, with some justification, that they should not be forced to pay a greater share of regulatory costs just because they opened first. It should also be noted, however, that gaming venues open now are operating in a less competitive – and therefore more lucrative – environment than those that will open later.

After consulting with the Gaming Control Board and considering comments from gaming licensees, the Department has developed the following procedure to draw down funds from the Section 1401 accounts:

As authorized by the Act, the Department of Revenue will draw a flat amount of \$800,000 from the Section 1401 account of each licensee open in Fiscal Year 2006-07, beginning tomorrow, January 31. We anticipate that five gaming facilities will be open in the current fiscal year. The \$800,000 withdrawals will be treated similarly to the existing \$36.1 million General Fund loan and will be recovered through compensating charges when all 14 licensees are up and running.

Additionally, the Department will continue to draw against each Section 1401 account at the rate of 1.5 percent of gross terminal revenue through the remainder of the current fiscal year, which ends June 30, 2007. To bring each account current, the initial draw on January 31 will also include an amount calculated at 1.5 percent of gross terminal revenue earned at each licensed facility, retroactive to the date the facility opened. Gross terminal revenue will be

calculated by subtracting the amount won from the amount wagered as shown on the daily invoice without excluding promotional play.

We believe this procedure will fairly distribute regulatory costs among all gaming licensees and allow the Gaming Control Board to fulfill its regulatory responsibilities for the remainder of the 2006-2007 Fiscal Year. It is not, however, sustainable past June 30, 2007, since it does not address currently outstanding or future costs of the Pennsylvania State Police, Department of Revenue or Attorney General.

At this point it may be helpful if I briefly explain how we settled on the procedure I just described. Once all gaming facilities are open – and based on current projections of gaming-related expenditures by the Gaming Control Board, Pennsylvania State Police, Department of Revenue – we estimate that regulatory costs will equal between 1.8 and 1.9 percent of Gross Terminal Revenue. In order to provide predictability to licensees, we decided to begin Gross Terminal Revenue-based withdrawals from the Section 1401 accounts at 1.5 percent. Withdrawals at that rate will not provide enough revenue to fund the Gaming Control Board this fiscal year. We will therefore need to collect an additional assessment of \$800,000 from each of the five licensees expected to open before June 30. Again, those \$800,000 assessments will eventually be recovered through compensating charges when the \$36.1 million General Fund loan is repaid, thereby preventing facilities that open first from paying an unfair share of regulatory costs.

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The Committee also requested information about expenditures related to gaming regulation.

The Department has two gaming-related responsibilities: procuring and overseeing the Central Computer System that monitors gaming throughout the Commonwealth, and collecting and distributing gaming taxes and assessments.

The Department of Revenue received a \$21.1 million appropriation under Act 71 to pay for the acquisition and operation of a Central Computer System and for the Department's gaming-related personnel and operating expenses. Because the appropriation exceeded the Department's projected expenditures, the Department was able to make a \$7.3 million loan from its appropriation to the Gaming Control Board in Fiscal Year 2005-06 and a \$6.6 million loan to the Gaming Control Board in Fiscal Year 2006-07.

The Department will spend \$1.27 million on personnel and operating costs related to the Central Computer System in Fiscal Year 2006-07. It will pay \$4.77 million to the Central Computer System vendor – GTECH Corporation – bringing the Department's total gaming-related costs this fiscal year to \$6.04 million. The Department will not require money from the Section 1401 accounts this fiscal year.

In Fiscal Year 2007-08, the Department anticipates gaming-related expenses of \$8.27 million. Of that total, \$2.34 million will be used for personnel and operating expenses, and \$5.94 million will go to GTECH Corporation for the Central Computer System. GTECH is paid a percentage of gaming revenues.

If you would like a more detailed explanation of the Department's gaming-related expenditures, I would be happy to provide that after I conclude my prepared remarks.

Since the Department's primary gaming-related responsibility is the procurement of and ongoing operation of the Central Computer System, I will conclude with an overview of what the system does.

The Central Computer System:

- Monitors the activity of all slot machines in play throughout the state.
- Calculates revenue due the Commonwealth based on that play.
- Calculates the proper distribution of taxes per Act 71.
- Prepares electronic invoices for each casino on every business day.
- Checks every machine at least once a day to make certain the machine's software has not been altered.
- Disables any machine when a pre-defined abnormal event occurs – such as an unauthorized door opening, software validation failure, etc.
- Provides full redundancy and disaster recovery capabilities so that casinos can remain open without a loss of gaming integrity should any component of the Central Computer System fail.
- Issues alerts to enforcement personnel when certain pre-defined events occur that may warrant disabling.
- Supports the most widely used industry communication protocol, permitting almost all manufacturers to offer machines to Pennsylvania gaming facilities.

- Provides real time online access to gaming and revenue data for authorized representatives of Department of Revenue, Pennsylvania Gaming Control Board and Pennsylvania State Police.

The Central Computer System also produces, on demand, 57 administrative reports on topics ranging from gameplay to site controller events to games by vendor.

The Department pays GTECH a monthly baseline charge of \$245,000, plus a percentage of Gross Terminal Revenue. The percentage goes down as Gross Terminal Revenue goes up. The total cost of the Central Computer System is capped at \$6.3 million a year

That concludes my prepared remarks. Are there any questions?

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