



Economic Impact Analysis Virginia Department of Planning and Budget

11 VAC 15-22 – Charitable Gaming Rules and Regulations

Department of Charitable Gaming

March 3, 2005

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

§18.2-340.15 of the Code of Virginia provides the Charitable Gaming Board (board) with the power to prescribe regulations and conditions under which gaming is conducted such that it is conducted in a manner consistent with the purpose for which it is permitted. It also vests the Department of Charitable Gaming (DCG) with control of all charitable gaming in the Commonwealth. Chapter 884 of the 2004 Acts of Assembly required that the board examine regulations, including the computation and percentage of gross receipts that are required to be used for charitable purposes by qualified organizations, and provide a report to the Governor and the 2004 Session of the General Assembly. The report was required to include the board's plan regarding regulatory action on these issues and the anticipated timetable for such action. The report, which was submitted on December 2, 2003, concurred that a comprehensive revision to the Charitable Gaming Rules and Regulations and the Supplier Rules and Regulations was

needed, including a review of the method for computation and the percentage of gross receipts required to be used for charitable purposes by qualified organizations.

The proposed regulation (1) establishes a uniform use-of-proceeds requirement of 10% for all organizations permitted or authorized to conduct charitable gaming and provides for additional flexibility to charitable gaming organizations in meeting this requirement, (2) expands the definition of what constitutes a discount and specifies that discounts provided by a charitable gaming organization in any given fiscal year not exceed 1% of the organization's previous year's gross receipts, (3) makes changes to the fee structure, (4) includes a number of changes that are intended to make the reporting process uniform, enhance the audit process, and reduce fraud and theft, and (5) reduces the maximum number of card faces that can be played per game on an electronic bingo machine from 72 to 54. In addition, the proposed regulation establishes rules for four new variations of bingo and raffle games (Decision Bingo, Lucky Seven, Treasure Chest, and Wingo), changes the fiscal year for reporting purposes from October 1 through September 30 to the calendar year, tightens requirements for the participation of minors in the operation, management, and conduct of charitable gaming, increases the maximum value of complimentary food and beverages provided to volunteers working a bingo session from \$8 to \$15, prohibits volunteers from playing bingo at any session they have worked once the session has begun, and modifies the notification requirements regarding the date, time, and location of charitable gaming events.

The proposed regulation also adds new definitions, deletes unnecessary definitions, and modifies existing ones. According to DCG, these changes are not likely to significantly alter current practice. The proposed regulation also includes a number of changes that make the regulation consistent with current practice and technology and with the Code of Virginia. Finally, the proposed regulation also includes a number of other changes that clarify aspects of the regulation and make it more streamlined. For example, the proposed regulation includes a new section that provides guidance regarding the suspension, revocation, or denial of a permit or authorization.

Estimated Economic Impact

Significant Changes:

(1) The proposed regulation establishes a uniform use-of-proceeds¹ requirement of 10% for all organizations permitted or authorized to conduct charitable gaming. Under the existing regulation, an organization's use-of-proceeds requirement is based on its annual gross receipts: the use-of-proceeds requirement is 5% for organizations with annual gross receipts of less than \$150,000, 10% for organizations with annual gross receipts between \$150,000 and \$500,000, and 12% for organizations with annual gross receipts over \$500,000. Thus, the proposed change will result in some organizations having to meet a higher use-of-proceeds requirement than currently required and others having to meet a lower one.

The average use-of-proceeds in FY 2003 was 14.3%.² Table 1 provides a breakdown of charitable gaming organizations (including fire departments and rescue squads) by annual gross receipts, as reported for FY 2003.

Table 1: Annual Gross Receipts, FY 2003

Annual Gross Receipts	Number of Charitable Gaming Organizations	Existing Minimum Use-Of-Proceeds Requirement	Current Use-Of-Proceeds
< \$150,000	192	5%	22.2%
Between \$150,000 and \$500,000	175	10%	13.2%
> \$500,000	261	12%	13.5%

Based on the number of charitable gaming organizations operating in the state, the minimum required use-of-proceeds requirement on a statewide basis is 9.3%. However, this requirement was exceeded on a statewide basis in each fiscal year since 1999. As Table 1 indicates, minimum use-of-proceeds requirements were exceeded in FY 2003 in each of the three annual gross receipt slabs. Given that each slab exceeded not only the existing use-of-proceeds requirement but also the proposed 10% requirement, the proposed change is not likely to affect current practice. Potentially, the biggest burden is on charitable gaming organizations making less than \$150,000 per year. They will be required to increase their minimum use-of-proceeds

¹ Use-of-proceeds is defined as the used of funds derived by an organization from its charitable gaming activities which are disbursed for lawful religious, charitable, community, or educational purposes.

² The use-of-proceeds for bingo sales was 12%, for raffle sales was 62%, and for fire departments and rescue squads was 21%.

from 5% to 10%. However, given the magnitude by which these organizations have exceeded the existing and proposed requirement in FY 2003, the proposed change is not likely to prove very burdensome. In fact, less than 30 bingo organizations out of a total of 458 (not including fire departments and rescue squads) had a use-of-proceeds of less than 10% in FY 2003. As these organizations increase their use-of-proceeds, it is likely to be reflected in a small increase in the amount of charitable gaming proceeds used for lawful religious, charitable, community, or educational purposes. However, the proposed change could also lead to some organizations making more than \$500,000 per year reducing their contribution towards approved charitable activities.

The proposed regulation also provides additional flexibility to charitable gaming organizations in meeting their use-of-proceeds requirement. According to DCG, current compliance with existing use-of-proceeds requirements is at 70%. Under the existing regulation, an organization not meeting its use-of-proceeds requirement has its permit suspended for a length of time based on its deficiency in meeting the requirement. Failure to meet the requirement three times results in the permit being revoked. If an organization is within one percentage point of meeting its use-of-proceeds requirement, it can request a one-time approval to make up the deficiency in the following fiscal year. Failure to make up the deficiency the following year results in a 30-day suspension of the permit. The proposed regulation removes the mandatory suspension and revocation of a permit for not meeting the use-of-proceeds requirements. Instead, organizations will be provided with the opportunity to implement a corrective action plan. Failure to adequately implement the plan could then result in permit being revoked or suspended. The proposed regulation also includes a new waiver provision that allows charitable gaming organizations to request a temporary reduction in the use-of-proceeds requirement. Finally, the proposed regulation removes limits on the amount of payments made to or on behalf of sick, indigent, or deceased members or their immediate families that can be included in the use-of-proceeds calculation. The existing regulation caps this amount at 1% of the prior year's gross receipts, with the exception of DCG approval of higher amounts under special circumstances.

The proposed change in the minimum use-of-proceeds requirement is likely to produce costs and benefits and the net economic impact will depend on the magnitude of these costs and

benefits.³ Given that the use-of-proceeds for each gross receipt slab exceeded not only the existing use-of-proceeds requirement but also the proposed 10% requirement, the proposed change is not likely to have a large effect on the amount of charitable gaming proceeds going towards approved charitable activities. However, some smaller organizations may be required to increase their contribution while some larger organizations may choose to reduce them. The net effect of these two changes is not known.

The evaluation of any change in the amount of charitable gaming receipts going towards approved charitable activities (increase or decrease) will depend on the comparative benefits of spending on approved charitable activities compared to spending on other types of goods and services. These benefits will depend on the type and nature of the charitable activities being undertaken. If the expenditures are well targeted and in areas where there is a significant need, increased spending for religious, charitable, community, or educational purposes could produce a net positive economic impact. For example, there is strong empirical evidence that, if spent effectively, expenditures on education are likely to produce increased growth in employment and per capita income in the state. However, it is not possible to make a precise determination of the net economic impact of the proposed change at this time. Such a calculation would require knowledge of the direction and magnitude of the change in spending on approved charitable activities and of the types of charitable activities that benefit or lose out as a result of the change.

(2) The proposed regulation expands the definition of what constitutes a discount and specifies that discounts provided by a charitable gaming organization in a given fiscal year not exceed 1% of the organization's previous year's gross receipts. The proposed regulation expands what constitutes a discount to include any purchases, not just purchases of admission tickets and game packs, made using coupons, free packs, or other similar methods. In addition, the proposed regulation requires the total discount provided to not exceed 1% of the organization's gross receipts from the previous year. The existing regulation does not limit the value of discounts provided by an organization. According to DCG, less than 10% of organizations currently provide more than 1% in discount. However, this percentage is likely to increase when using the expanded definition of what constitutes a discount.

³ The increased flexibility to meet the use-of-proceeds requirement is not likely to have a significant economic impact. To the extent that it provides charitable gaming organizations with additional ways of meeting their use-of-proceeds requirement at no significant additional cost to them or to the state, the proposed change could produce some small economic benefits.

DCG believes that the proposed change will increase the amount of charitable gaming proceeds spent on approved charitable activities. Use-of-proceeds is calculated as a percentage of an organization's annual gross receipts. However, annual gross receipts are reported after discounts. Thus, assuming the number of bingo and raffle tickets sold remains unchanged, a reduction in the amount of discount will be reflected in an increase in gross receipts. This, in turn, will result in a larger amount of charitable gaming proceeds being spent on approved charitable activities. However, this argument hinges on the assumption that the number of bingo and raffle tickets sold remains unchanged despite a reduction in the amount of discount provided. However, in reality, it is more likely that bingo and raffle ticket sales will decline with a reduction in discount. The net impact on gross receipts will depend on the magnitude of the decline in bingo and raffle ticket sales compared to the increase in revenues from providing fewer discounts.

Thus, the net economic impact of the proposed change remains unclear. The impact on the amount of charitable gaming proceeds going toward approved charitable activities is itself not clear. As discussed in the previous section, estimation of the net economic impact of a change in the amount of the proceeds being used for charitable purposes (increase or decrease) would depend on the direction and magnitude of the change and on the types of charitable activities that benefit or lose out as a result of the change.

(3) The proposed regulations makes changes to the existing fee structure. The fee for reviewing and issuing an interim certification for charitable gaming has been increased from \$250 to \$500. According to DCG, the existing fee is not adequate to cover the costs incurred in conducting the review and issuing the certification. The activities of charitable gaming organizations when conducted improperly could result in fraud and theft. The aim of the charitable gaming rules and regulations is to reduce the potential for fraud and theft. Fees charged for the review and issue of interim certification can be viewed as part of the compliance cost incurred by charitable gaming organizations to ensure that they do not jeopardize public safety. Given that current fees do not cover the cost to DCG of conducting the review and issuing the certification, charitable gaming organizations are not paying the actual compliance cost associated with operating in a manner protective of public safety. Increasing the fees will transfer some or all of this cost to charitable gaming organizations and result in a more efficient allocation of resources. With some of the cost being subsidized by DCG (and hence the

taxpayers), charitable gaming organizations are not paying costs commensurate with the risk posed to public safety from their activities. This could potentially result in more unsuitable and substandard businesses and individuals seeking to enter the industry than if fees reflected actual costs. Increasing fees such that they better reflect costs will ensure that charitable gaming organizations seeking to enter the industry are of a certain quality and the risk to public safety from their activities is kept at a level deemed appropriate.

The proposed regulation also modifies the fee structure for permits issued for less than one year. Under the existing regulation, permits for less than one year are charged a prorated fee: the \$200 permit fee is rounded off to the nearest \$50 per quarter. The proposed regulation eliminates the prorating provision. Applicants for certification will be required to pay the \$200 annual certification fee even if the certification is issued for less than a year. According to DCG, certification for less than a year is issued under two circumstances: new applicants who have no prior gaming experience and applicants for renewal who have been found to be delinquent or in violation of the regulation in the past. If all initial certification requirements are met under the former scenario and appropriate corrective action has been taken under the latter scenario, DCG automatically extends the certification for the balance of the year at no additional cost. However, if the applicant does not comply with initial certification requirements or does not undertake appropriate corrective action, the certification expires. As conditions for obtaining a permit for less than one year appear to be the same as the conditions for obtaining it for a full year, the cost to DCG of reviewing the application and issuing the permit is likely to be the same under both circumstances. Thus, charging a fee that is identical to the fee charged for full-year permits and that reflects the actual cost of review and issuance will result in a more efficient allocation of resources (see discussion above).

While both the fee changes are likely to result in a more efficient allocation of resources and have an overall net positive economic impact, the magnitude of the impact is likely to be small. According to DCG, the agency does not routinely issue interim certifications. In fact, only two interim certifications have been issued since 2002. Moreover, the agency has not received any requests for and nor has it charged prorated fees to-date. While the agency does routinely issue certifications for less than one year, the certification is extended for the full year in most cases. In the past 18 months, there have been two instances when applicants did not have their certification extended and voluntarily quit the industry.

(4) The proposed regulation includes a number of changes that are intended to make the reporting process uniform, enhance the audit process, and reduce fraud and theft. Some of these changes include more extensive record keeping of a charitable gaming organization's finances, its use-of-proceeds, and its gaming and gaming supply (used and unused) documentation. Other changes include requiring all charitable gaming organizations to use door prize tickets with serial numbers printed on them, store gaming supplies in a secure area, announce door prizes at the end of the game, not alter bingo paper from its original form, not co-mingle seal card deals, return unused gaming supplies to DCG or the manufacturer, provide more information on raffle tickets and electronic bingo machine receipts, and not use a general fund account to pay for expenses and to meet use-of-proceeds requirements. In addition, the proposed regulation requires charitable gaming organizations with gross receipts between \$25,000 and \$50,000 to submit quarterly reports.⁴ The proposed regulation also removes the existing cap on the penalty for not submitting required reports, not requesting an extension, or not making fee payments.⁵ However, not all the proposed changes are likely to result in higher costs. Many, such as online reporting and additional flexibility in permit application and renewal requirements, are intended to streamline the recordkeeping and notification process and make it less burdensome. DCG believes that any increase in costs is likely to be counterbalanced by changes that streamline the process and make it more efficient.

Discussion of costs apart, the proposed changes are also likely to produce economic benefits. According to DCG, they are intended to facilitate better enforcement of the law and of the requirements of the regulation. As mentioned previously, there is a potential for fraud and theft in the charitable gaming industry. The changes being proposed are intended to increase accountability and reduce the potential improper conduct. In 2004, 20 felony and two misdemeanor charges were brought against six individuals, with seven charges resulting in guilty verdicts, two charges not being prosecuted, and 13 charges pending court action. According to DCG, there are 21 investigations currently in progress. According to a 2003 Joint Legislative

⁴ According to DCG, the additional reporting requirement is not likely to impose significant additional costs as most charitable gaming organizations affected by the proposed change use the services of volunteer accountants in preparing their reports. For organizations hiring the services of a professional, the hourly cost could range from \$25 per hour to \$100 per hour. DCG estimates that it takes 1-2 hours to prepare a financial report.

⁵ The penalty is \$25 per day up to a maximum of \$750 under the existing regulation. The proposed regulation eliminates the \$750 cap.

Audit and Review Commission (JLARC) report⁶, 54 out of the 75 audits of charitable gaming organizations conducted between October 2001 and September 2002 found revenues being underreported, by an average of \$116,141 or a total of \$6.3 million. In fact, audits were routinely found to uncover problems, including the underreporting of gross proceeds. However, the report found that only a small fraction of the organizations identified for audits actually got audited. For example, in 2002, 632 organizations were identified for audit for a number of reasons including excessive prize payouts, excessive player discounts, and insufficient charitable giving, but only 26 were actually audited. Thus, to the extent that the proposed changes facilitate the audit process, they are likely to increase the number of audits conducted by DCG in any given year and produce significant economic benefits in terms of fraud reduction.

The net economic impact of the proposed changes will depend on the magnitude of the costs and benefits associated with them. Precise estimate of the costs and benefits are not possible at this time. However, based on the above discussion of the magnitude of underreporting uncovered by audits, it appears likely that the benefits of better audit and enforcement will outweigh any additional costs associated with the proposed requirements.

(5) The proposed regulation reduces the maximum number of card faces that can be played per game on an electronic bingo machine from 72 to 54. Reducing the maximum number of card faces, in turn, reduces the chances of an individual winning and receiving a payout. According to DCG, the proposed change is intended to level the playing field between paper and electronic players. A good paper player can play up to 36 card faces simultaneously. By being able to play a larger number of card faces during a game, electronic bingo players have a higher probability of winning. However, reducing the maximum number of card faces from 72 to 54 is not likely to achieve much by way of leveling the playing field. Electronic bingo players are likely to continue to have an advantage over paper players. At the same time, reducing the likelihood of a payout using for electronic bingo players could discourage people from playing and, consequently, have a negative impact on charitable gaming proceeds. Organizations currently using and manufacturers currently supplying machines with a maximum 72 card faces will incur additional costs associated with replacing or modifying their equipment to comply with the proposed change.

⁶ “Review of the Charitable Gaming Commission”, House Document No. 22, Report of the Joint Legislative Audit and Review Commission to the Governor and General Assembly of Virginia, 2003.

However, any negative economic impact is likely to be small. According to DCG, a maximum of 54 card faces is the national standard. The agency estimates that less than 2% of charitable gaming organizations will be affected by the proposed change. Moreover, according to the agency, the cost to suppliers of making the change is likely to be minimal. Regulation requires that the games be loaded onto the computers onsite, usually just before the game begins. The proposed change will simply require 54 instead of 72 games being loaded. Given the limited number of organizations offering games with 72 card faces, the costs associated with the proposed change, both in terms of discouraging people from playing and having to replace or modify equipment, is likely to be small.

Other Changes:

The proposed regulation makes a number of other changes. However, these changes are not likely to have significant economic impact.

- The proposed regulation establishes rules for four new variations of bingo and raffle games: Decision Bingo, Lucky Seven, Treasure Chest, and Wingo. However, these games are currently being played in Virginia and the rules established in the regulation are largely based on current practice.
 - The proposed regulation changes the fiscal year for reporting purposes from October 1 through September 30 to the calendar year, i.e., January 1 through December 31. The change is intended to make the reporting process consistent with the state's budgeting process. According to DCG, currently budget projections of revenues from charitable gaming are based on just three months of actual data (July through October). After the proposed change, six months of actual data (July through December) will be available to the agency when making revenue projections. Moreover, the agency believes that consistency between the reporting period for charitable gaming and the reporting period for tax purposes will reduce confusion among the regulated community and streamline the reporting process. To the extent the proposed change achieves these objectives, it is likely to produce some small economic benefits.
 - The proposed regulation tightens requirements for the participation of minors in the operation, management, and conduct of charitable gaming. It prohibits individuals under the age of 18 from participating in the management and operation of a bingo game and
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individuals between the ages of 11 and 13 from participating in the conduct of a bingo game when not accompanied by a parent or legal guardian. The existing regulation allows individuals eleven and older to participate in the management, operation, and conduct of bingo games, as long as the minors have parental consent. As the existing regulation already provides charitable gaming organizations with the flexibility to limit the participation of minors in bingo games, the proposed change is not likely to have a significant economic impact.

- The proposed regulation increases the maximum value of complimentary food and beverages provided to volunteers working a bingo session from \$8 to \$15. The existing limit was set in 1996.⁷ According to DCG, the proposed increase was requested by charitable gaming organizations. As the proposed amount appears to be reasonable, the increase in the maximum value of complimentary food and beverages provided to volunteers is not likely to have a significant economic impact.
- The proposed regulation prohibits volunteers from playing bingo at any session they have worked once the session has begun. According to DCG, this change is intended to reduce the risk of fraud and cheating as well as the appearance of impropriety. To the extent that it does so, the proposed regulation could produce some small economic benefits.
- The proposed regulation modifies the notification requirements regarding the date, time, and location of charitable gaming events. The limit on the number of times an organization can make changes to the date, time, and location of a charitable gaming event in a given year has been removed.⁸ In addition, organizations are no longer allowed to make these changes based on special events and holidays. According to DCG, the initial scheduling of games should account to special events and holidays. The proposed change in the notification requirements is not likely to produce a significant economic impact.

Businesses and Entities Affected

The proposed regulation affects all organizations permitted or authorized to engage in charitable gaming. According to DCG, there currently are 458 organizations permitted and 170 organizations (fire departments and rescue squads) authorized to conduct charitable gaming. In addition, there are 22 suppliers of gaming supplies operating in Virginia.

⁷ The 2004 inflation-adjusted value is \$9.63.

⁸ It is currently restricted to a maximum of six.

Localities Particularly Affected

The proposed regulation applies to all localities in the Commonwealth.

Projected Impact on Employment

The proposed regulation is not likely to have a significant impact on employment in Virginia.

Effects on the Use and Value of Private Property

The proposed regulation makes some changes that are likely to increase operation costs for organizations involved in charitable gaming. This, in turn, will reduce the asset value of these businesses. However, the proposed regulation also makes changes are likely to reduce operating costs and have a positive impact on asset values. The net effect of the proposed regulation will depend on the relative magnitude of both these sets of changes. While a precise determination of the magnitudes and, hence of the net effect, is not possible at this time, the overall impact of the proposed regulation on the use and value of private property is not likely to be very large.