

Chapter 3

Ministry of Government Services

Section 3.03

Charitable Gaming

Background

Under the Criminal Code of Canada, provinces are assigned the responsibility for operating, licensing, and regulating legal forms of gaming. A charitable organization, pursuant to a licence issued under the authority of the province, can conduct and manage charitable gaming provided that the net proceeds are used for a charitable purpose. The Alcohol and Gaming Commission of Ontario (Commission) was established on February 23, 1998, as a regulatory agency that operates under the *Alcohol and Gaming Regulation and Public Protection Act, 1996*. Its mandate relating to charitable gaming is to ensure that the games are conducted in the public interest, by people with integrity, and in a manner that is socially and financially responsible.

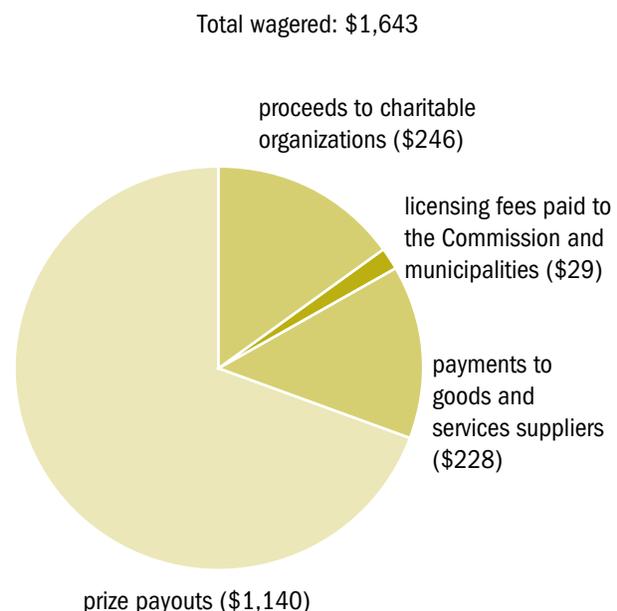
Ontario is one of the largest charitable gaming markets in North America. The Commission estimates that approximately \$1.6 billion was wagered in 2003 by the public on charitable gaming province-wide. Charitable gaming activities include bingo events, sales of break-open tickets (a type of instant-win lottery ticket, also called Nevada or pull-tab tickets), and local and province-wide raffles. Each single occasion of such an activity is known as a lottery event. Charitable gaming in Ontario benefits thousands of local community charitable organizations, which received net rev-

enues estimated by the Commission at \$246 million for 2003. (See Figure 1.)

The Commission is responsible for charitable gaming using a regulatory framework of legislation and policies, supplier and employee registrations, licensing of lottery events, inspection, and enforcement. It assumed responsibility for the administration of legislation previously administered by the former Gaming Control Commission. Annually, the Commission registers about 9,600 businesses and individuals, and issues about 2,600 lottery licences,

Figure 1: Estimate of Money Wagered in Charitable Gaming, 2003 (\$ million)

Source of data: Alcohol and Gaming Commission of Ontario



primarily for province-wide or large-dollar lottery events. The province has granted municipalities the authority to issue licences, and they issue about 43,000 licences annually for smaller local lottery events.

In the 2004/05 fiscal year, the Commission spent approximately \$11 million on its charitable gaming-related regulatory activities, primarily for staffing costs, and received approximately \$30 million in fees from charitable gaming sources (see Figure 2).

The Commission's operations are located at its main head/regional office in Toronto and nine regional offices in Ontario. Regional offices are staffed with members of the Ontario Provincial Police and liquor licence inspectors, who conduct inspections of gaming facilities and break-open ticket sellers.

Audit Objective and Scope

Our audit objective was to assess whether the Commission had adequate systems and procedures in place to:

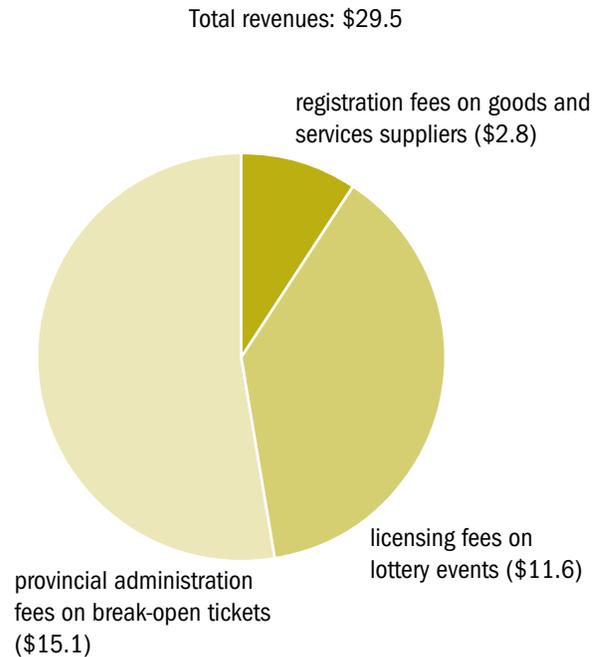
- effectively and efficiently fulfill its mandate of ensuring that charitable gaming is conducted in the public interest, by people with integrity, and in a manner that is socially and financially responsible; and
- ensure compliance with legislation and Commission policies that are established for charity gaming.

Our audit fieldwork included a review of relevant files and administrative policies and interviews of staff at the Commission's head office and three regional offices.

In addition to our work at the Commission, we also met with lottery licensing representatives from six municipalities and with the Ontario Charitable

Figure 2: Charitable Gaming Fees Paid to the Province, 2004/05 (\$ million)

Source of data: Alcohol and Gaming Commission of Ontario



Gaming Association, which represents a number of charities involved in charitable gaming activities. We surveyed approximately 100 municipalities with lottery licensing offices about their views on the delivery of the charitable gaming program. We received excellent co-operation from the municipalities, with over 90% of them responding to our survey.

Our audit was conducted in accordance with standards for assurance engagements, encompassing value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

We did not rely on the Ministry of Government Services' internal auditors, who provide their services to the Commission, to reduce the extent of our procedures because they had not conducted any recent work in the areas covered by our audit.

COMMISSION'S DISAGREEMENT WITH SCOPE

Prior to the commencement of our audit, we identified the audit criteria that would be used to conclude on the audit objective. These were reviewed by senior Commission management and accepted, except for the following criteria that pertained to the Commission's relationship with municipalities:

- Clearly defined roles, responsibilities, and performance expectations are understood by all parties.
- Appropriate oversight is in place to ensure compliance with gaming legislation and to ensure that performance expectations are met.
- Processes have been established to report on performance and mechanisms for ongoing exchange of information and to provide for consistency in approaches to the extent possible among licensing authorities.

Senior management at the Commission did not believe that it has the legislative authority to oversee municipal licensing activities. Notwithstanding, we still considered it necessary as part of our audit to evaluate whether the Commission had established effective relationships with municipalities, particularly since municipalities issue the vast majority of licences and the Commission is responsible for regulating charitable gaming in the province. This matter is discussed in the Oversight of Municipal Gaming section of this report.

Summary

Municipalities issue close to 95% of the charitable gaming licences issued in Ontario. Since the Commission believes it does not have the legislative authority to oversee municipal licensing activities, it had not established any processes for doing so. However, we believe the Commission's interpretation of its legislative authority is overly narrow.

Without appropriate oversight of and co-ordination with municipalities' licensing activities, the Commission cannot effectively fulfill its mandate of ensuring the honesty and integrity of gaming in the province. For instance, it has no assurance that charitable organizations are getting the proceeds from gaming that they are entitled to and that those proceeds are being used for charitable purposes.

Feedback we received from almost 100 municipalities identified best practices and a number of areas where the Commission's support to municipalities could be improved. Many municipalities indicated that they would appreciate additional support and guidance in determining charitable organizations' eligibility and assessing their financial reporting. As an example of a best practice that could be promoted among municipalities, we noted that an ongoing program of licence reviews developed by one municipality had identified over \$3 million of charitable proceeds since 1997 that should have been used for charitable purposes but were not.

We also noted several areas where the Commission-delivered regulatory activities required strengthening, as follows:

- The Commission has generally established good registration requirements to assess the character, financial history, and competence of the key players in the charitable gaming industry. However, it did not ensure that these requirements were consistently met, nor did it periodically verify whether registrants adhered to the terms and conditions of registration.
- Procedures were often not followed with respect to assessing an organization's eligibility for a licence, ensuring that lottery proceeds were used for approved charitable purposes, and verifying that required terms and conditions of a licence were met. New licences were still provided to organizations for subsequent lottery events without evidence of any follow-up on missing documents required from the

organization, such as reports of the use of proceeds from previous lottery events.

- The Commission had not established formal policies for inspections and enforcement with respect to charitable gaming activities, such as using a risk-based approach to planning and conducting its inspections. For example, no inspection programs or audits were conducted for the two break-open ticket manufacturers that serve all of Ontario or for the approximately 50 break-open ticket agents, which supply about 90% of all tickets from these manufacturers. For inspections and investigations that were carried out on bingo operators and break-open ticket sellers, half of the municipalities we surveyed indicated that they were not informed of the results by the liquor licence inspectors or the OPP.
- In 1997, the Management Board of Cabinet provided funding to strengthen controls and ongoing funding to hire six additional staff to monitor and audit the production and distribution of break-open tickets. However, many of the key controls and the six dedicated staff approved to oversee this high-risk area were never put in place. Consequently, the Commission had no assurances that adequate controls were in place over break-open ticket sales or that the \$15 million that ticket manufacturers were remitting to the province as the provincial administration fee was the correct amount.

We also made recommendations for ensuring that the Commission follows prudent project management practices, including the requirements of the Management Board of Cabinet directives governing information technology projects and use of consultants. We further recommended that the Commission develop more comprehensive indicators for measuring and reporting on its performance with respect to charitable gaming and include municipalities' contribution to regulating gaming activities in its indicators.

Detailed Audit Observations

RECENT COMMISSION INITIATIVE

Changing market conditions over the last decade have resulted in a significant decline in the number of charities raising funds through charitable gaming, and for those charities that have continued to do so, there has been a significant decline in the revenues generated. For instance, in 1996 the gross amount wagered on bingo was estimated by the Commission at \$1.2 billion; by 2003, the estimated gross wager for bingo had declined to just over \$1 billion. In 1997, sales of break-open tickets were estimated at \$1.2 billion; by 2003, estimated sales had declined to \$360 million. The supporting industry has also suffered, with the number of break-open ticket sellers and the number of bingo centres declining by almost 50% since the early 1990s.

As regulator, the Commission does not promote charitable gaming, but rather focuses on ensuring that its regulatory framework allows the industry to operate in an efficient and effective manner.

In May 2005, the Commission initiated a comprehensive review of the charitable gaming regulatory structure—the first since the current structure was put in place in the early 1990s—to ensure that the regulatory structure was adequate to achieve its objectives. These objectives include charitable gaming activities that are honest, have integrity, meet expected standards, and help organizations meet their financial needs to deliver charitable programs to their communities.

A major part of the review involved a consultation process during the summer of 2005 to obtain input from interested parties that will be used to help develop the key priorities, and best solutions and recommendations, for positive change.

Figure 3: Summary of Licensing Framework for Lottery Events

Prepared by the Office of the Auditor General of Ontario

Events Licensed by Commission	Events Licensed by Municipalities
bingo events for prizes totalling over \$5,500	bingo events for prizes totalling \$5,500 and under
ticket raffle lotteries for total prizes over \$50,000	ticket raffle lotteries for total prizes of \$50,000 and under
break-open ticket lotteries that sell throughout the province or at bingo events	break-open ticket lotteries for local community organizations
all lottery events conducted in unorganized territories	bazaar lotteries with prizes up to \$500
all lottery events at designated fairs or exhibitions	
social gaming events	

OVERVIEW OF REGULATORY FRAMEWORK

Charitable organizations wishing to hold lottery events must apply for a licence and manage their events in accordance with the terms and conditions of the licence. To be eligible for a licence, an applicant must be a not-for-profit organization that funds and/or operates charitable programs for the relief of poverty, the advancement of education or religion, or other charitable purposes beneficial to the community. The organization must also have been in existence for at least one year, have established itself in Ontario, and use the lottery event's net proceeds to directly benefit Ontario residents (for instance, with few exceptions, net proceeds cannot be used to fund the charitable organization's overhead expenses or for charitable activities outside Ontario).

The licensing framework and the limits of provincial and municipal licensing are prescribed under Order-in-Council, as summarized in Figure 3.

The terms and conditions of a licence require the organization to provide the Commission or municipality, within 30 days after the lottery event, with a financial report that outlines the results of the lottery event and how the proceeds were used. Each year, the organization must also provide a financial statement outlining the financial details of all lottery events conducted during the fiscal year.

For organizations that obtain net lottery proceeds of \$50,000 or more during a year, the financial statements are required to be reviewed for reasonableness by a licensed public accountant. These organizations must also provide a compliance report from a public accountant assessing compliance with licensing terms and conditions and with regulations relating to the lottery events.

Municipalities issue almost 95% of charitable gaming licences in Ontario. During the 2003/04 fiscal year, they issued about 43,000 licences and received fees of about \$17 million. A municipality may attach licence terms and conditions in addition to those established by the Commission provided that they do not conflict with provincial terms and conditions or policies.

To assist municipalities in exercising their authority, the Commission establishes the terms and conditions for each type of licence, provides guidance on determining an organization's eligibility for a licence, provides training, and conducts and may assist in compliance and enforcement activities.

In the 2003/04 fiscal year, the Commission issued about 2,600 provincial lottery licences for large-dollar or province-wide lottery events and collected fees of approximately \$11.6 million.

Under the *Gaming Control Act, 1992*, businesses and individuals that supply gaming equipment and services to charitable gaming activities

must be registered by the Commission after passing a background check. In the 2003/04 fiscal year, the Commission registered about 9,600 bingo hall operators, bingo paper and break-open ticket manufacturers, gaming service and equipment manufacturers and suppliers, break-open ticket agents (who supply tickets on behalf of charitable organizations to break-open ticket sellers), break-open ticket sellers, and key employees (known as gaming assistants) in gaming establishments.

To assess compliance with legislation and Commission policy, and to identify and address violations, the Commission is also responsible for conducting inspections and investigations of gaming equipment and services suppliers and, where warranted, charitable organizations.

The province has standards and regulations in place to ensure the integrity of the charitable gaming industry and that gaming is conducted in the public interest. Notwithstanding the existing regulatory framework, we identified areas where administration needed to be strengthened to ensure that the standards and regulations were adhered to.

OVERSIGHT OF MUNICIPAL GAMING

Commission Roles and Responsibilities

The Commission informed us that the province and municipalities are partners in licensing charitable gaming activities. Beyond that, however, senior Commission management was of the opinion that, outside of establishing the terms and conditions of licensing and providing municipalities with directions and training, the Commission had no obligation and legislative authority to oversee municipal lottery licensing programs. Such oversight could include ensuring that licences are actually issued to organizations in accordance with the Commission's requirements, such as those regarding eligibility, use of proceeds, and financial reporting. The information routinely requested from municipalities

was limited primarily to statistics on the number of licences issued and the total fees collected.

We believe the Commission's interpretation of its legislative authority is overly narrow. Municipalities issue close to 95% of the charitable gaming licences issued in Ontario annually. Therefore, without appropriate oversight of and co-ordination with municipalities' licensing activities we believe that the Commission cannot effectively fulfill its responsibility of ensuring the honesty and integrity of gaming in Ontario in any meaningful manner.

In addition, the Minister of Government Services is ultimately accountable for the effective administration of the gaming legislation and for the actions taken by the Commission. In this regard, under the current accountability relationship, in our opinion the Commission is a critical link between the municipalities and the province in helping the Minister fulfill his or her mandate. We believe that the governing Order-in-Council provides the Commission with substantial authority for ensuring that licences, including those issued by municipalities, meet minimum standards. For instance:

- The Commission may determine whether a charitable organization is eligible for a licence to conduct and manage a lottery event. Municipalities are required to determine eligibility using the Commission's policies.
- The application for a licence and the licence issued by a municipality are required to be in the form prescribed by the Commission.
- The Commission may attach terms and conditions to any licence, and a municipal council may attach terms and conditions to a licence issued by the municipal council. However, in the event that the terms or conditions imposed by a municipal council conflict with those imposed by the Commission, the ones imposed by the Commission apply.
- The Commission may at any time suspend or cancel a licence issued by a municipal council

if the licence was not issued in accordance with the Commission's policies or guidelines.

- A report prescribed by the Commission or a copy of each licence issued by a municipal council is required to be forwarded to the Commission.

We recognize that municipalities have substantial independence. However, in our opinion, the Order-in-Council does not limit the Commission in its ability to oversee and to request information pertaining to municipalities' licensing operations. Given that the Commission establishes policies and procedures, we believe that it has the authority to ensure that those policies and procedures are being adhered to. In our interpretation, the Commission not only has the legislative authority to oversee municipal licensing programs but likely has an obligation under the legislation to do so.

As a result of the limited amount of information available at the Commission, we found it necessary to survey municipalities to request more useful information, as well as their opinions regarding such matters as their licensing procedures, reliance on the Commission for training and support, enforcement activities, and quality control processes. The results of an over 90% response rate to our survey and our discussions with a number of municipalities' lottery licensing representatives clearly conveyed to us that they strongly supported actions that would help ensure that charitable gaming activities were administered in accordance with high standards. Specifically, it was clear to us that municipalities were interested and would be cooperative in sharing information on their activities, experiences, and best practices with the Commission and would be interested in the experiences of other municipalities in dealing with charitable organizations.

Municipal Licensing Activities and Best Practices

Our discussions with representatives of municipalities and the results of our survey identified significant variances between municipal licensing operations with regard to information and information systems, training provided to charitable organizations, procedures for verification of proceeds, and inspection and enforcement activities. We noted that many municipalities had already established quality-control procedures for their licensing operations, but others had not. We believe that the Commission could provide valuable guidance on establishing such procedures to ensure that appropriate and consistent standards are met for issuing licences across the province.

We also identified certain areas where the Commission's support to municipalities could be improved. For example, the licensing policies and procedures provided by the Commission to the municipalities were outdated. Municipalities indicated that updating and change were most needed in the following areas: determining organizations' eligibility, assessing organizations' use of proceeds, and reviewing organizations' financial reporting. In addition, over 70% of the municipalities surveyed indicated that some sort of regular training would be useful.

Many of the charitable organizations serving local communities are limited by their small size. As a result, they must rely heavily on volunteers (who might not be knowledgeable about operating a business) and/or employ only a few employees to deliver and manage their operations. Therefore, municipalities require sufficient funding to adequately monitor charitable gaming licences issued to these organizations and ensure that licensing terms and conditions are met. In this regard, we noted that the revenues that most municipalities, especially the larger ones, received from lottery licensing did exceed the costs of delivering their licensing programs. Several municipalities had used

gaming licence revenues to establish additional monitoring activities that we believe other municipalities could find useful in administering their licensing programs.

For example, one municipality (which received licensing fees of \$274,000 in the 2003/04 fiscal year) established an ongoing program of engaging a public accountant, at a cost of about \$70,000 per year, to conduct financial reviews with respect to all licences issued to the charitable organizations within its jurisdiction. The public accountant routinely found significant deficiencies in the charitable organizations' lottery-related financial records. As a result of these reviews, since 1997 inappropriate and ineligible expenses of over \$3 million were identified. The municipality informed us that organizations were required to correct any deficiencies before being granted future licences. In other examples, municipalities supplemented the inspections and investigations activities carried out by the Commission with their own by using bylaw enforcement officers or by hiring additional local police.

We believe that by taking a more proactive role in working with municipalities to disseminate best practices and to co-ordinate training and quality assurance, the Commission could better fulfill its responsibility of ensuring fair gaming that meets regulatory requirements.

RECOMMENDATION

To fulfill its legislated responsibilities and ensure that charitable gaming in Ontario is effectively regulated, the Commission should work with municipalities to establish appropriate oversight and support for municipal licensing activities that includes:

- ensuring that the respective roles of the municipal councils and the Commission are clearly articulated and accepted to eliminate any gaps or duplication in regulating charitable gaming in Ontario;

- obtaining sufficient, relevant information from municipalities to allow meaningful assessment of the effectiveness of licensing activities province-wide;
- implementing procedures for sharing information and promoting best practices; and
- conducting ongoing assessments of the training and policies that it provides to municipalities and addressing any needs identified.

COMMISSION RESPONSE

The Commission is guided by its interpretation of Order-in-Council 2688/93, as amended, in its relationship with municipalities. This interpretation is one that respects municipal councils' autonomy and decision-making. The Commission has taken several steps to improve its support for municipal licensing activities, including:

- establishing strategic working groups for the bingo and break-open ticket sectors of the charitable gaming market (the strategic working groups include representation from municipalities through the Association of Municipal Managers, Clerks and Treasurers of Ontario [AMCTO]);
- releasing a revised Lottery Licensing Policy Manual in May 2005 that included all changes in policy to early 2005 (a series of seminars have been scheduled in co-operation with AMCTO for municipal licensing officers);
- providing, through Commission staff attending in the municipality, ongoing training on topics specified by individual municipalities or groups of municipalities; and
- providing ongoing assistance by telephone on a day-to-day basis.

The Commission believes that the regulation of charitable gaming should allow the industry to be competitive and raise necessary funds for charitable and religious organizations. Also,

regulation must ensure that the industry is operated with honesty, integrity, in the public interest, and in a responsible manner. To this end, the Commission released a consultation paper on the modernization of charitable gaming in May 2005. The results of that consultation will lead to consideration of further changes in the regulatory structure and the making of recommendations to the government with respect to the role of municipal councils and their accountability for the licensing activity.

In regard to the Auditor General's findings, the Commission acknowledges that limited information is available on municipal licensing activities. The Commission will work with municipalities and the AMCTO to explore areas for greater co-operation and information-sharing. This will also include further improving any training and support municipalities may require.

COMMISSION-DELIVERED REGULATORY ACTIVITIES

Registrations

As part of the process of registering suppliers and gaming assistants, the Commission investigates applicants' character, financial history, and competence. It can deny, suspend, or revoke a registration if there are reasonable grounds to believe that the applicant will not be responsible in conducting its business and will not act in accordance with law or with integrity, honesty, or in the public interest.

For the 2003/04 fiscal year, the Commission received registration fees totalling about \$2.8 million from registrations issued to about 9,600 gaming equipment and services suppliers (two print manufacturers, and about 125 bingo halls, 50 break-open ticket agents, 5,700 break-open ticket sellers, and over 3,600 gaming assistants).

Gaming suppliers are required to post a registration certificate at their establishments, and a photo ID issued by the Commission is to be worn by gaming assistants while working at gaming establishments.

Controls over Registration Process

The Commission has established several key controls over the registration process. For example, Ontario Provincial Police officers assigned to the Commission annually conduct investigations of registrants that may include checking their financial, criminal, and legal status, and contacting references. In addition, each registration has terms and conditions attached (such as requirements for proper accounting and security), with provisions that permit the Commission to verify compliance.

However, we noted that the Commission was not adequately ensuring that the established requirements were being met. For instance:

- Registered large businesses, including most bingo operators, break-open ticket agents, and ticket manufacturers, are required under the terms and conditions of registration to provide annual financial statements reviewed by a licensed public accountant. However, we noted that gaming registration officers often accepted financial information that had not been reviewed.
- The Commission did not have a process in place for periodically verifying whether registrants adhered to the stated terms and conditions of registration. For instance, the terms and conditions of registration for bingo operators, break-open ticket agents, and ticket manufacturers indicate that adequate controls are to be put in place over accounting records and sales, and for preventing fraud and safeguarding assets. However, registrants are not requested to periodically submit—at the time of either initial registration or renewal—compliance reports reviewed by a licensed public accountant confirming that the

terms and conditions of registration were met; nor were there any inspections of ticket manufacturers and agents to ascertain whether these internal controls were in place.

- The registration process for gaming assistants did not include a check to verify the picture of the applicant, nor were references checked. As a result, a risk exists that photo IDs could be granted to gaming assistants who were not properly assessed for registration. We noted that a similar concern was reported by the Auditor General of Alberta in 2003/04, specifically with respect to the Alberta Gaming and Liquor Commission's gaming-worker-registration process. In addition, the registration process did not consider two significant areas:

- There was no policy established to help identify which situations or relationships constitute a conflict of interest that would require resolution. For example, we noted an instance in which gaming registration officers knew about but did not question ownership relationships between a print manufacturer, a break-open ticket agent, and a bingo operator. Besides representing a potential conflict of interest, these relationships could make it easier for businesses to undertake illegal activities that are difficult to detect.
- The provincial tax status of business applicants is not verified as part of the registration process, although doing so would further assist the Commission in assessing an applicant's financial status and lawful behaviour. We noted four cases where companies were recently registered with the Commission even though their tax status was not in good standing and amounts as high as \$15,000 were owed to the province.

We noted that these two areas are required to be considered in other programs. For example, before engaging most goods and services suppliers, provincial ministries are required to assess any potential conflict-of-interest situations and to verify that the supplier's tax status is in good standing. In addi-

tion, under the *Liquor Licence Act*, the Commission may refuse to grant a licence if a conflict-of-interest relationship exists between a liquor manufacturer and a person or business that promotes or serves alcoholic beverages. We were informed by the Commission that changes to the *Gaming Control Act, 1992* might be required before such controls could be implemented.

RECOMMENDATION

To help ensure that registrations of charitable gaming equipment and services suppliers and gaming assistants are granted only to those that meet high standards of honesty and integrity, the Commission should:

- enforce the requirement that registrants submit annual financial statements reviewed by a licensed public accountant;
- implement procedures for periodically verifying that registrants have complied with the terms and conditions of registration; and
- verify that the information provided by prospective registrants is legitimate and accurate.

In addition, the Commission should establish policies and procedures for ensuring that conflict-of-interest situations are appropriately dealt with. It should also consider the benefits of requiring verification that, where applicable, prospective registrants' provincial tax status is in good standing.

COMMISSION RESPONSE

The Commission believes it is essential to maintain high standards of honesty and integrity in the regulation of the charitable gaming industry. The Commission will continue to build on these standards, and the recommendations of the Auditor General will be considered in the context of the modernization of charitable gaming and the Commission's information technology

plans. Additional policies will be developed and procedures implemented where appropriate with respect to the specific recommendations.

The Commission does review conflicts of interests between its registrants but will ensure that its policies in this regard are properly documented.

Verification of Registration

Charitable organizations applying for a licence must record on their applications the registration numbers of any gaming suppliers they plan on using for their lottery event. For licences issued by the Commission, gaming registration officers who issue licences can verify the registration status of these suppliers by accessing the Commission's registration database.

For municipally issued licences, the Commission had not made clear to municipalities the need to verify the registration of gaming suppliers used by charitable organizations. In our discussions with and survey of municipalities, over half of the municipalities indicated that it was not their responsibility to check whether a supplier's registration was valid or up to date, and almost 30% indicated that they did not verify the registration of suppliers used by organizations that applied for a licence.

The municipalities that did verify registration had asked organizations to submit copies of their suppliers' registration certificates along with their licence applications. The Commission's registration database, which would be more up to date and accurate, was not accessible by municipalities. To obtain more up-to-date registration information about a gaming supplier, municipalities would have to contact the Commission on a case-by-case basis.

RECOMMENDATION

The Commission should clearly communicate to municipalities the requirement to verify that charitable organizations seeking licences are using properly registered charitable gaming suppliers. It should also provide municipalities with up-to-date information—possibly through access to its registration database—for use in verifying the gaming suppliers' registration.

COMMISSION RESPONSE

The Lottery Licensing Policy Manual sets out the procedures to be used in making licensing decisions. The Commission agrees that municipalities should have access to relevant information on the registration database to verify gaming suppliers' registration. Such access to the database by municipalities would be dependent upon having the appropriate resources to develop an information technology system.

The Commission will consult with municipalities on the need to verify registration as part of the licensing process. This will include identifying best practices and any additional supports that can be provided by the Commission to municipalities to help accomplish the verification of registration in a cost-effective manner.

Licensing Activities

Licensing Practices

The Commission's gaming registration officers are required to review applications from charitable organizations to ensure that eligibility requirements are met before issuing a licence; they are also required to follow up after lottery events to ensure that the terms and conditions of the licence—including any reporting requirements—are met. We

identified the following areas where improvements are required in the Commission's licensing practices:

- There was often no evidence that an organization's eligibility was assessed before awarding or renewing a licence. Our audit noted that in a number of cases there were no core files on the licensed organizations. A core file contains all the background information on the organization that would be used in determining its eligibility, including its incorporation papers, a description of its charitable programs and services, information on its financial status, the names of its board of directors, and financial reports filed. Where a core file was available, it was often outdated and did not reflect recent changes in the organizations' environment, such as the names of key contacts.
- There was inadequate effort to verify the organization's use of net proceeds from the lottery event to ensure that these funds were used for approved charitable purposes. Almost two-thirds of the organizations whose reports we examined did not provide information on how the proceeds were spent. When details on the use of proceeds were provided, in about one-third of the cases we examined the organization had not demonstrated it spent the proceeds as required by the organization's charitable mandate or within required expense limits.
- For about two-thirds of the files we examined, we noted that the Commission had not obtained financial statements and compliance reports from the charitable organizations as required under its policy. When financial statements for organizations receiving over \$50,000 annually were received, the statements did not have the required review conducted by a licensed public accountant.

Even though the required financial information following lottery events was not provided to gaming registration officers, new licences were still issued to these organizations for subsequent lottery

events without evidence of any follow-up on the missing documents.

RECOMMENDATION

To help ensure that licences are granted only to legitimate charities, the Commission should more critically evaluate the eligibility of charitable organizations. In addition, to ensure that proceeds from lottery events are used for approved charitable purposes, it should:

- obtain and properly assess the required reports on lottery events; and
- issue renewal licences only if an organization has met the reporting requirements for all previous lottery events.

COMMISSION RESPONSE

While the current process for reviewing licence applications from charities is quite thorough, the Commission recognizes improvements can be made in providing more training, revised policies, and improved documentation standards.

In addition, the Commission will consider the Auditor General's recommendations as part of the modernization of charitable gaming. In the long run, new technology is required to conduct reviews in an efficient manner. A new lottery licensing system is being developed in a phased approach.

Bingo Sponsor Associations

Charitable organizations with municipal licences for bingo events at large bingo halls often choose to form a bingo sponsor association to enable them to apply jointly for the provincial licences required to also hold bingo events with prizes totalling greater than \$5,500. Representing as many as 50 charitable organizations, the bingo sponsor association distributes the proceeds from provincially licensed events to each charitable organization in

the association. According to the Commission, proceeds from provincially licensed bingo events were estimated at \$119 million for 2003.

The Commission had no oversight procedures in place to provide any assurance that the net proceeds raised by bingo sponsor associations were distributed to the individual charities and ultimately used for approved charitable purposes. Rather, the Commission informed us that it expected the municipalities that have the bingo halls in their jurisdiction to verify the use of proceeds that charitable organizations received from provincially licensed events in conjunction with their responsibility for verifying the organizations' use of proceeds from municipally licensed events.

However, we found that municipalities were not informed of the Commission's expectations. Our survey of municipalities revealed that over half the municipalities that had bingo hall(s) in their area indicated that they did not verify the charitable organizations' use of proceeds from provincially licensed events. Among the municipalities that did verify the use of such proceeds, we noted that several had actually revised the Commission-issued reporting forms to better ensure charitable organizations' complete reporting of the use of the proceeds.

RECOMMENDATION

To help ensure that proceeds from provincially licensed bingo events are used for approved charitable purposes, the Commission should work with municipalities to establish procedures for verifying the charitable organizations' use of proceeds distributed through bingo sponsor associations.

COMMISSION RESPONSE

The Lottery Licensing Policy Manual provided to municipalities covers the procedures to be used for ensuring that funds received from

provincially licensed bingo events are used for charitable purposes. The Commission will take steps to remind municipalities, during training sessions starting in September 2005, of their responsibility to ensure that these funds are verified along with other net proceeds received relating to municipally issued licences.

Controls over Break-open Tickets

For 2003, the Commission estimates that the gross wager on break-open tickets in Ontario was \$360 million. Net profits to charitable organizations were about \$46 million after prize payouts, licensing fees paid to either the Commission or municipalities, and payments to break-open ticket manufacturers, agents, and sellers. There has been a substantial decline in sales of such tickets since 1997, when the gross wager was estimated at \$1.2 billion and organizations retained net profits of about \$120 million.

In 1997, Management Board of Cabinet approval was given to the then-Gaming Control Commission to implement new controls over the production of break-open tickets and their distribution to charitable organizations. At the time, there were concerns regarding fraudulent activities, including ticket tampering, unreported sales, and the potential for printing and selling more tickets than allowed for by a licence. Regulating break-open tickets sales in Ontario was problematic due to the numerous manufacturers and ticket agents in the marketplace, many of which were located outside the province, and the lack of controls over the production and distribution of these tickets.

New controls planned for in 1997 included having the Commission establish service management contracts with separate suppliers to deliver:

- a production system in which tickets would be bar-coded to facilitate tracking and auditing; and

- a central ordering system for all charitable organizations, and a secure warehousing and distribution system.

Approval was also received to establish a team of Commission staff to negotiate and manage contracts with, monitor the performance of, and audit the functions contracted to these suppliers.

The funding provided to the Commission by the Management Board of Cabinet to implement the new controls was \$1.25 million in each of the first two years, \$1.1 million in the third year, and \$0.6 million annually thereafter for the ongoing cost of six permanent staff.

In November 1997, the then-Gaming Control Commission implemented the first of the new controls envisioned. Two manufacturers, both located in Ontario and competitively selected, commenced an exclusive arrangement to print break-open tickets for the Ontario market. Contracts and registration requirements for these manufacturers require that adequate controls be put in place, particularly for accounting records, sales, preventing fraud, and safeguarding assets.

However, we noted that the remaining key controls authorized and funded by the Management Board of Cabinet were not implemented:

- No central ordering, warehousing, and distribution system was established. Agents and some charitable organizations purchase tickets directly from manufacturers.
- No dedicated team of permanent staff was established to negotiate and manage contracts with the private suppliers, and to monitor the performance and audit the functions contracted to the private sector.
- The Commission had not established procedures for monitoring break-open ticket production and sales. Many of the weaknesses in these areas are covered in other sections of this report, including the failure to obtain compliance reports and to conduct regular inspections of internal control procedures in place at the two print manu-

facturers and at the approximately 50 ticket agents.

When tickets are sold directly to a charitable organization, the manufacturers imprint the charitable organization's name and licence number on each ticket. We noted that ticket agents, which supply almost 90% of all break-open tickets manufactured to break-open ticket sellers, are permitted to acquire tickets in bulk without providing manufacturers with the licence numbers of the charitable organizations on whose behalf the tickets are being supplied. This makes it possible for tickets to be sold illegally without a licence.

RECOMMENDATION

To ensure that adequate controls exist over the production, distribution, and sale of break-open tickets, the Commission should:

- identify and implement key controls authorized by Management Board of Cabinet over manufacturers and ticket agents that would provide adequate assurances that they are complying with legislative requirements and the Commission's terms and conditions of registration;
- reconsider the need for an independent central distribution and warehousing supplier for break-open tickets; and
- establish procedures for periodically verifying the accuracy of reported break-open ticket sales.

COMMISSION RESPONSE

The Commission supports the recommendation to improve controls over break-open tickets and has already initiated a review of options on how to do so. The options will be considered as part of an overall control strategy for break-open ticket sales.

Provincial Administration Fee

In 1997, the Management Board of Cabinet also approved the implementation of a provincial administration fee of 5% of break-open ticket sales. At the time, the new fee was projected to return about \$40 million annually to the Consolidated Revenue Fund. Manufacturers are required to collect and remit this fee, and to report break-open ticket sales to the Commission.

Between the fee's December 1997 implementation and March 31, 2004, manufacturers submitted approximately \$150 million in provincial administration fees, including about \$15 million during the 2004/05 fiscal year.

In April 1998, internal auditors from the then-Ministry of Consumer and Commercial Relations reviewed the Commission's revenue controls. Their report noted that the Commission had not asked the manufacturers for audited financial statements and reports on their internal controls and had initiated no inspections aimed at obtaining assurances on the reliability of the manufacturers' accounting records with respect to collecting, reporting, and remitting the provincial administration fees. According to the report, Commission management had agreed to take corrective action, but no changes were ever implemented in this regard.

During our audit, we observed that the Commission continued to rely solely on information provided by the manufacturers and had no procedures in place (such as periodic audits by Commission staff, internal auditors, or an independent public accountant) to verify that the fees submitted actually represented 5% of total sales.

We noted several examples of discrepancies between the manufacturers' sales reports and the sales information we requested from agents and charitable organizations. For example, in one case we found \$235,000 in apparently unreported sales, which would have resulted in a loss to the province of over \$11,000 in the provincial administration fee. Further assessment of these discrepancies

would be required to substantiate whether the differences in the information we received were the result of errors by the manufacturer, the agents, or the charitable organizations.

One cost-effective option would be for the Commission to ask that the two manufacturers provide a report from their auditors confirming the gross sales and related 5% provincial administration fee. A special report of this nature is sanctioned by the Canadian Institute of Chartered Accountants, and, assuming that the two manufacturers each engage external auditors to audit their financial statements, providing such a report should result in little or no additional cost to the manufacturers.

RECOMMENDATION

To ensure that the Commission has adequate assurance that the correct amounts of provincial administration fees are remitted by break-open ticket manufacturers, the Commission should request that the manufacturers provide independent audit assurance on their reported sales and fees payable. Alternatively, if this more cost-effective option is considered not feasible, independent audits by Commission staff should be conducted periodically.

COMMISSION RESPONSE

The Commission supports the recommendation and in fall 2004 announced changes to the supply of break-open tickets. Effective May 2005, the market was "opened" to additional manufacturers who had consented to new terms to registration that include certain requirements with respect to audits that apply to all manufacturers.

Charitable Gaming Inspections and Enforcement

Because inspections are an important means of assessing a registrant's compliance with legislative requirements and with the terms and conditions of registration, they play a key role in promoting voluntary compliance. The visible presence of inspectors also helps promote public confidence that gaming standards are being enforced. While other sources of information, such as public complaints, are important for helping to identify gaming violations, inspections can be proactive in preventing such occurrences.

Inspecting break-open ticket sellers is the responsibility of liquor licence inspectors, who are trained to do the work using a standardized checklist. For the 2004/05 fiscal year, there were approximately 600 inspections of break-open ticket sellers that resulted in over 1,000 warning/caution notices and four prosecutions. Inspections of bingo facilities are conducted by the Ontario Provincial Police (OPP) officers assigned to the Commission. There were 36 such inspections in the 2004/05 fiscal year. The OPP also conducted about 80 investigations—either of gaming equipment and services suppliers or of charitable organizations (or their employees or volunteers)—resulting in six charges laid under either the Criminal Code or the *Gaming Control Act, 1992*.

Items typically checked during an inspection include whether registration and licence certificates are posted for viewing by the public, whether adequate security is maintained for tickets or bingo paper, and whether gaming assistants are wearing Commission-issued photo IDs.

We found that the Commission did not have formal policies in place for managing its charitable gaming inspection activities. As a result, little direction was available to OPP officers and liquor licence inspectors on the various aspects of an inspection, such as objectives, priorities and coverage, frequency, actions to take when violations are identi-

fied, and follow-up of violations. We identified a number of areas in the Commission's inspection and enforcement activities where improvements could be made:

- Inspections were not based on formal risk assessments. For example, liquor licence inspectors generally conducted inspections of break-open ticket sellers on their own initiative and had to meet minimal quotas of only two inspections per month. A risk-based approach to prioritizing break-open ticket sellers for inspections should be considered, since it would take almost 10 years at the current rate to inspect the over 5,700 sellers.

For bingo hall inspections, the Commission had not worked with the OPP to develop a consistent approach. For example, there were large variations in the frequency of inspections between the three regions we visited: the 16 bingo operators in one region were targeted for inspection once per year; the eight bingo operators in the second region were targeted for inspection once every two years; and the third region, having discontinued several years ago any regular inspections of the 37 bingo operators in its area, conducted an inspection only when a complaint was received.

- Our analysis of the results of inspections of break-open ticket sellers by liquor licence inspectors during the 2004/05 fiscal year identified a non-compliance rate of about 60% of the inspected sellers. Common violations identified by liquor licence inspectors included instances where financial records were not being kept, winning tickets were not defaced to prevent their reuse, and the tickets available for sale did not correspond to the licence issued. There were very few prosecutions of violations, probably because the infractions were too small to merit the cost of prosecution. Better education and additional enforcement measures—such as fines that can be imposed simply by issuing a ticket

during the inspection—may be necessary to promote voluntary compliance by sellers.

- Inspections of bingo operators and break-open ticket sellers are limited to physical observation of certain key requirements, such as whether a licence is posted. Inspections do not include reviewing accounting records to ensure that all sales and ticket inventories were accounted for and that sellers' commissions were within prescribed maximums.
- No inspection programs or audits are established for certain key gaming suppliers—namely, the two bingo paper and break-open ticket print manufacturers that serve all of Ontario; and the approximately 50 break-open ticket agents, which supply about 90% of all tickets from these manufacturers to sellers on behalf of charitable organizations.

In addition, municipalities play a key role in monitoring local charitable organizations through the licensing process and may either formally or informally monitor the local gaming equipment and services suppliers used by these organizations. For example, we noted that a number of municipalities independently initiated and conducted regular inspections of bingo operators and break-open ticket sellers. However, the Commission did not have a policy of providing municipalities with feedback on the results of inspections and investigations that it performed in their jurisdiction. Half of the municipalities we surveyed indicated that they were not informed of the results of the inspections and investigations conducted by the liquor licence inspectors or the OPP. Such information would help municipalities in making decisions regarding the issuing of a licence, including whether or not to impose additional terms and conditions they feel are necessary, and in monitoring local gaming equipment and services suppliers. The Commission also did not seek information on the results of the inspections carried out by municipalities, although

these results could be useful in planning its own inspection efforts.

RECOMMENDATION

To be more effective in ensuring the integrity of charitable gaming, the Commission should develop and implement a formal strategy and policies for its inspection activities that include a risk-based approach to target high-risk gaming equipment and services suppliers.

The Commission should also investigate the extent to which better education and additional enforcement measures are needed to achieve a high level of voluntary compliance with legislative requirements and with the terms and conditions of registration.

In addition, to improve inspection and enforcement activities at both the provincial and municipal levels, the Commission should work with municipalities on sharing information about the results of inspections and investigations.

COMMISSION RESPONSE

The inspections and enforcement organizational structure was reviewed during the winter of 2004/05. A new organizational structure was put in place in June 2005 to address issues with respect to the Commission's entire mandate. As part of the implementation of the new organizational structure, changes will be made in enforcement and inspection strategy. The Commission will continue to build on its risk-based enforcement and inspection strategy, not only within charitable gaming but also within the context of its overall mandate, which includes liquor enforcement and commercial gaming. The Auditor General's recommendations will be considered as part of the implementation of the new organizational structure and development of enforcement and inspection strategy.

Information Technology Project

The Commission uses two separate computer systems for its licensing and registration systems. It has concluded that the systems are old and in need of replacement to ensure a stable, open, efficient, and integrated environment. Since 2003 the Commission has been performing the planning work for an integrated licensing and registration system.

In January 2005, the Commission initiated a project to replace the lottery licensing system, which was considered a higher-risk system due to its age and use of older technology. The Commission is required to adhere to the Management Board of Cabinet's Management of Information Technology Directive, which requires that formal project management processes be followed, including documented justification for the plan, detailed project plans, efficient organization of resources, project approvals, progress reporting, and post-project evaluation.

Project Planning

We found that there was no business case established for the project that would meet the requirements of the Directive. Specifically, the project documents we reviewed did not address:

- total one-time costs, including staff costs, associated with planning, designing, acquiring, and implementing the project;
- ongoing costs over a four-year period associated with maintenance of the new system;
- risk assessment, which would explain the project's degree of exposure to disruption or reduction in services to the public and to cost overruns; and
- project benefits quantified in monetary and non-monetary terms.

Following our fieldwork, the Commission indicated that it had prepared a business case that estimated the project's total costs to be about \$610,000. The primary estimated costs were for

Commission staff time totalling \$313,000 and for consulting fees of \$286,000, the latter of which had already been incurred. The system will be developed in-house using the Commission's staff and using existing hardware. However, the business case did not include the costs incurred in planning for an integrated licensing and registration system before January 2005 or any ongoing maintenance or other costs beyond the expected September 2006 implementation date of the licensing system.

Without an adequate business case that includes objectives, costs, time estimates, and an analysis of buy-versus-build alternatives, it is difficult for senior management to make informed decisions. This was emphasized by the recent Report of Ontario's Special Task Force on the Management of Large-Scale Information and Information Technology Projects. The report stated that "IT projects that have gone off-track often had ill-defined business plans."

Project Management

We identified several concerns regarding the ongoing management of the project:

- Project documentation was not up to date. The project charter, which authorizes the project scope, approach, deliverables, timelines, and individual team member responsibilities, estimated that the system would go live in December 2005. However, the project timetables have since changed this date to September 2006. Notwithstanding that and related changes, weekly progress reports made to senior Commission management indicated that project scope, costs, schedule, and changes were all on target. However, there were no indications in the weekly reports as to what the target completion dates or costs were for each phase of the implementation—information that would allow senior management to properly assess the project's progress.

- Contrary to the Directive's requirements, there was no internal auditor involved in the project. Internal audit's involvement during the various stages of the project would be useful for ensuring that key controls over project management and system design were established and adhered to.

In addition, the Commission's use of a consultant on this project did not conform to established government policies and practices and to the Management Board of Cabinet's Procurement Directive for Consulting Services. We noted the following:

- The costs of a consultant to complete this project were originally estimated at \$135,000. The selection of the consultant was based on an internal vendor-of-record arrangement established by the Commission in October 2003. We noted that only one contract—for a fixed price of \$60,000—had been established for this assignment; that contract was signed on March 18, 2005, between the Commission and the consultant. However, the consultant was paid a total of \$286,000 from invoices dated February 16, 2005 to March 24, 2005. Thus, in addition to the consultant doing work before a contract was in place, the consultant was paid over four times the contracted amount.
- According to the Commission, the consultant still had unfinished work at the time of the last invoice: for example, two key reports on project design were not delivered until April 28 and May 18, 2005. However, senior Commission management informed us that no further payments to the consultant following its March 24, 2005 invoice would be necessary, which would indicate that the consultant was fully paid as of March 24, 2005 before key deliverables were received, contrary to payment practices required in the Directive. In addition, the consultant estimated the cost of its involvement in the design stage of the project, which hadn't been started, to be a further \$150,000 to ensure that the proposed project timelines are met. We noted that the Commission's business case did not include these costs.
- According to the vendor-of-record agreement between the consultant and the Commission, all invoices from the consultant were required to provide a breakdown of names and hourly rates of the consultant's employees who performed the service and details of the work performed in relationship to the hours spent. We observed that invoices provided to the Commission did not provide this information, and further details were obtained only upon our request during the audit. Based on this additional information, we noted that the rates charged by the consultant were not in accordance with the rates authorized in the October 2003 agreement. For instance, an hourly rate of \$440 was charged for one employee when the authorized rate was \$375 per hour, resulting in an overpayment of \$3,120. Other employees with hourly rates of \$180, \$210, and \$270 could not be matched with the agreement. Also, no details of the work performed in relationship to the hours spent were made available.

RECOMMENDATION

To ensure value for money and comply with the Management Board of Cabinet's directives governing information technology projects and the use of consultants, the Commission should:

- provide decision-makers with a comprehensive business case before proceeding with the development of information technology projects;
- involve ministry internal auditors in the oversight of projects to verify that key controls over project management, system design, and the use of consultants are established and adhered to;

- require that project documentation be up to date and that reports to senior Commission management include relevant and accurate information on project status; and
- ensure that a valid written contract is in place with consultants before authorizing work, budgeted amounts are not exceeded without proper justification and approval, invoices are scrutinized, and payments are made only after services are rendered.

COMMISSION RESPONSE

The decision to replace the lottery licensing system was made by senior management after two years of study and review. The current lottery licensing system was no longer supportable, and there was a substantial risk that it could not be resuscitated if it crashed. Such a situation would be “mission critical,” as lottery licensing would be severely affected. While senior management was satisfied that the various documents and analysis provided a comprehensive assessment for the decision on a replacement, it is acknowledged that the process did not conform to the requirements of Management Board of Cabinet’s directives and that controls need to be strengthened for consulting engagements.

Audit-resource involvement in information technology projects is based on overall Ontario Public Service risk. At the time of this particular information technology project, the limited internal audit resources were focused on projects that were deemed to be of higher risk. Notwithstanding, senior management will invite internal audit at appropriate points in the overall project and will ensure that, in future, a process that follows directive requirements will be used for all information technology projects and use of consultants.

Measuring and Reporting on Program Effectiveness

The Commission is required to provide an annual results-based plan that reports on performance from the previous year and outlines plans for the coming years. An annual report is also to be provided to the Minister for tabling in the Legislative Assembly. The annual report should contain information on the achievement of performance targets and on action to be taken, along with an analysis of the agency’s operational and financial performance. Such reports are intended to inform legislators and the public about the extent to which programs and services are meeting program objectives and providing value to the public. These annual plans and reports not only serve as a vehicle for focusing attention on results and for driving change but also foster openness and accountability.

The Commission’s 2003/04 Annual Report contained two performance measures: one covering consumer protection and the other on customer satisfaction. Neither of these measures was specific to charitable gaming, nor were they presented in a manner that would allow for any meaningful assessment of the Commission’s performance.

The Annual Report also reported on the number of registrations and licences issued. This information allows assessment of how the Commission’s resources were applied but does not provide an indication of the outcomes of its registration and licensing activities, including the extent to which the Commission had obtained compliance by the industry to charitable gaming legislation and the Commission’s regulatory policies.

More meaningful performance information on the Commission’s activities could have included the following:

- results of the Commission’s inspection and enforcement activities, including the number and results of inspections, investigations, complaints, licences and registrations suspended or revoked, and any disciplinary action taken;

- trend information and benchmarking to other jurisdictions—that is, a comparison of the current year’s performance with prior years’ and other jurisdictions’ performance;
- information on the extent to which service levels—such as the number of licences and registrations processed within established time frames—met a standard (which the Commission would need to establish); and
- charitable gaming fees collected by the Commission in relationship to the costs of its enforcement activities, a measurement that would allow for assessing the Commission’s capacity to fund its regulatory activities in relationship to the fees collected with respect to such activities.

We noted that several other jurisdictions have included information in their annual reports on the extent and results of their regulatory activities.

In addition, the Annual Report contained no information on the success of the municipalities’ regulatory activities with respect to charitable gaming. Regular reporting by each municipality to the Commission was very limited and was used by the Commission only for estimating the total licences issued by municipalities.

RECOMMENDATION

To enable the Commission to report to legislators and the public on its effectiveness in regulating charitable gaming, the Commission should develop more comprehensive indicators for measuring and publicly reporting on its performance. The Commission should also consult with municipalities to regularly obtain meaningful information that would allow the Commission to also include municipalities’ contribution to regulating charitable gaming activities in its results-based plans and annual reports.

COMMISSION RESPONSE

The Commission will consider new measures as part of its review of charitable gaming and the proposed modernization of the regulatory structure.