

Performance Audit Report

**Video Lottery Operation Licensees
Minority Business Participation**

November 2011



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

November 10, 2011

Karl S. Aro
Executive Director

Bruce A. Myers, CPA
Legislative Auditor

Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee
Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

As required by Section 9-1A-34 of the State Government Article of the Annotated Code of Maryland, we audited information on the attainment of minority business participation goals submitted to the State Lottery Commission (SLC) by video lottery operation licensees and the efforts to maintain those goals. Our audit covered the licensees' construction and procurement activities for the Hollywood Casino Perryville and the Casino at Ocean Downs from the applicable license award dates through December 31, 2010.

Our audit disclosed that the licensees provided accurate information on minority contractor participation for their construction and procurement activities and their efforts regarding these goals appeared reasonable. However, we noted that minority contractor participation data furnished to the SLC by the Governor's Office of Minority Affairs (GOMA), which monitors and reports to the SLC regarding compliance with the minority participation requirements, contained certain errors that understated participation. These errors occurred because GOMA was not aware of certain payments made to minority contractors near the end of the reporting period and because of calculation errors made by GOMA's monitoring contractor. These participation data were included in the State Lottery Commission's 2010 annual report issued March 1, 2011. For example, the minority participation for the Hollywood Casino was reported as \$10.9 million instead of \$11.7 million. The overall minority business participation for the two licensees after adjusting for the errors was 20.7 percent and 19.8 percent as shown in the tables on pages 7 and 8.

We wish to acknowledge the cooperation extended to us during our audit by SLC, GOMA, and the licensees.

Respectfully submitted,

Bruce A. Myers
Bruce A. Myers, CPA
Legislative Auditor

Background Information

Video Lottery Facilities

During the 2007 special session, the General Assembly adopted legislation to license video lottery terminal (VLT) gaming in Maryland. In the November 2008 general election, the voters of Maryland ratified a constitutional amendment authorizing up to 15,000 VLTs in five locations in the state (Anne Arundel County, Baltimore City, Cecil County, Allegany County, and Worcester County). Upon approval of this constitutional amendment, the law which authorized the licensing of VLT gaming became effective.

The video lottery operation licenses required by law to operate a VLT facility are awarded by the Video Lottery Facility Location Commission. The State Lottery Commission (SLC) oversees VLT operations and owns or leases the VLT equipment. The SLC is required to ensure that licensees comply with the regulatory framework of the VLT program, including minority business participation.

Status of Licenses

Licenses have been awarded to operate VLT casinos in Cecil, Worcester, and Anne Arundel Counties. The casinos in Cecil and Worcester Counties began VLT gaming operations on September 27, 2010 and January 4, 2011, respectively. Ground breaking for construction of the casino in Anne Arundel County took place on January 27, 2011. As of August 3, 2011, the Video Lottery Facility Location Commission was accepting bids to operate the VLT facilities in Baltimore City and at Rocky Gap in Allegany County.

Minority Participation Requirements

Section 9-1A-10 of the State Government Article of the Annotated Code of Maryland specifies that, for construction and procurements related to the operation of VLTs, video lottery operation licensees must, at a minimum, meet the same minority participation requirements specified for state agencies in Title 14, Subtitle 3 of the State Finance and Procurement Article. According to this law, if the Governor's Office of Minority Affairs reports that a licensee is not in compliance with the minority participation requirements, SLC may take immediate action to ensure compliance of the licensee. The law also specifies that, if the county in which a video lottery facility will be located has higher minority business participation requirements than the State, the licensee must meet the county's requirements to the extent possible. The counties in which VLT gaming operations have begun (Cecil and Worcester Counties) do not have higher minority participation requirements than the State.

The request for proposals (RFP) issued in December 2008 by the Video Lottery Facility Location Commission delineated the minority participation goals for each site as follows:

Overall goals:

Anne Arundel County	minimum 35 percent
Baltimore City	minimum 35 percent
Cecil County	minimum 25 percent
Worcester County	minimum 25 percent
Allegany County	minimum 25 percent

Sub-goals (for all jurisdictions):

African American owned businesses	minimum 10 percent
Women owned business	minimum 10 percent

Because of constitutionality issues, the Attorney General of Maryland has subsequently advised that the contractual provisions relating to these goals need to be amended.

Governor's Office of Minority Affairs

Section 9-1A-10 of the State Government Article of the Annotated Code of Maryland also requires the Governor's Office of Minority Affairs (GOMA) to monitor licensees' compliance with the minority participation requirements and to report at least every six months to the SLC on the licensees' compliance with the requirements. GOMA hired a private contractor to assist with the monitoring efforts and determinations of the minority participation levels achieved by the licensees. The SLC uses the information from GOMA to prepare its annual report to the Governor and the General Assembly on the attainment of the minority business participation goals by the licensees and their efforts to maintain those goals. SLC's first report, which is for calendar year 2010, was issued on March 1, 2011.

Minority Requirements Study

Section 4 of Chapter 4, Special Session, Laws of Maryland 2007 requires the Maryland Department of Transportation (MDOT), in consultation with the General Assembly and the Office of the Attorney General, to initiate two studies to evaluate the continued compliance of the minority participation requirements of Section 9-1A-10 of the State Government Article with any federal and constitutional requirements. The studies are also to evaluate race-neutral programs or other methods that can be used to address the needs of minority investors and minority businesses. A final report of the first study was due to the Legislative Policy Committee by December 15, 2010, and a final report of the second study is due to the Committee by September 30, 2013.

In bill review letters related to the VLT legislation, the Attorney General of Maryland advised the Governor that, absent a study that demonstrates the need for the minority participation requirements, the law establishing the minority participation requirements should not be enforced. The Attorney General basically noted that the minority participation requirements will be upheld if the State can demonstrate that race or gender conscious remedies are necessary to further the State's interest in remedying the effects of past discrimination.

Subsequent to the completion of our fieldwork, the Secretary of MDOT sent a letter (dated August 9, 2011) and certain other documents, including the required study, to the Legislative Policy Committee to address the requirements of Chapter 4, Special Session, Laws of Maryland 2007. In response, the Attorney General advised in an August 11, 2011 letter to the President of the Maryland Senate and Speaker of the House that a minority business participation program may now be implemented in compliance with the law. However, to implement the program, the Attorney General advised that the SLC should set separate goals for each licensee based on the proposed contract work and the availability of minority businesses to perform the work. Also, waivers must be available for instances in which the licensee is unable to meet the goals after making good faith efforts. The Attorney General advised that it will be necessary to amend the outstanding RFP and the contractual provisions to accurately reflect this methodology. The SLC has begun this process for the existing licensees.

Audit Scope, Objectives, and Methodology

Scope and Objectives

Section 9-1A-34 of the State Government Article of the Annotated Code of Maryland requires the Office of Legislative Audits to audit and evaluate the information submitted by video lottery operation licensees to the State Lottery Commission (SLC) on the attainment of minority business participation goals specified for construction and procurement and the efforts to maintain those goals. Specifically, we assessed the accuracy of the information reported by the video lottery operator licensees and the reasonableness of the efforts to maintain the goals. We have audited the information from the following video lottery operation licensees since award of their respective licenses through December 31, 2010:

- Penn Cecil Maryland, Inc., licensed October 21, 2009 to operate 1,500 video lottery terminals (VLTs) at the Hollywood Casino Perryville (Cecil County).
- Ocean Enterprise 589 LLC, licensed September 23, 2009 to operate 800 VLTs at the Casino at Ocean Downs (Worcester County).

Our audit was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Methodology

To accomplish our objectives, we interviewed individuals employed by the licensees and employees of the minority subcontractors. In addition, we interviewed the Governor's Office of Minority Affairs (GOMA) personnel and the employees of their contractor responsible for collecting and reporting the minority participation data and outreach efforts. We also reviewed the minority participation calculations for accuracy, and reviewed and tested the records of the licensees, including contractor classifications, expenditure data, invoices, and reports of minority participation levels and outreach efforts.

Our fieldwork was completed between January and May 2011. A copy of the draft report was provided to the SLC and GOMA. Their responses to our findings and recommendations appear as appendices in our audit report. As prescribed in State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the SLC and GOMA regarding the results of our review of their responses.

Conclusions

We concluded that, for the licensees tested, the licensees provided accurate information on minority contractor participation for their construction and procurement activities and their efforts regarding these goals appeared reasonable. However, we noted that minority contractor participation data furnished to the SLC by GOMA contained certain errors that understated participation.

Our audit also disclosed that the licensees engaged in substantial activities toward achieving the minority business participation goals, including holding diversity fairs and outreach events, and employing direct phone and direct email solicitations. As a result, there was broad participation by minority business enterprises as suppliers and in various construction trades, including themed lighting, drywall, mechanical, steel and metals, truck services, concrete, aluminum and glazing, rebar installation, structural steel, electrical improvement materials, cable installation, slots chairs, office furniture and other equipment, ceiling materials, ceramic tile flooring, and traffic lights.

Finding and Recommendation

Reported Minority Participation

Finding 1

The licensees' minority participation data reported by the Governor's Office of Minority Affairs (GOMA) to the State Lottery Commission (SLC) contained certain inaccuracies that resulted in the understatements of minority participation.

Analysis

Our audit disclosed that the licensees' minority participation data reported by GOMA to SLC understated the minority participation achieved by the licensees. SLC used the data it received from the GOMA in its calendar year 2010 annual report on the video lottery terminal (VLT) facilities to the Governor and General Assembly.

The data were inaccurate because GOMA was not aware of certain payments made by licensees to minority contractors near the end of the reporting period and because of calculation errors made by GOMA's monitoring contractor. However, SLC took no action to ensure the reported data were reasonably complete and accurate, although the SLC included the data in its annual report. The tables below present both the reported results and the results as adjusted for the noted errors.

Hollywood Casino Perryville (Cecil County) Activity through December 31, 2010					
Minority Classification	Target Goal ¹	Reported to/by SLC		Adjusted Results	
		Total Payments to MBEs	MBE Goal Achievement	Total Payments to MBEs Based on Audit Test	MBE Goal Achievement
Overall	25%	\$10,943,755	19.3%	\$11,719,819	20.7%
Women	10%	\$ 5,390,263	9.5%	\$ 5,912,818	10.5%
African American	10%	\$ 4,300,701	7.6%	\$ 4,312,976	7.6%
Other	None	\$ 1,252,791	2.2%	\$ 1,494,025	2.6%

¹ As previously noted, the Attorney General of Maryland has advised that the contractual provisions relating to these goals need to be amended.

Casino at Ocean Downs (Worcester County) Activity through December 31, 2010					
Minority Classification	Target Goal ²	Reported to/by SLC		Adjusted Results	
		Total Payments to MBEs	MBE Goal Achievement	Total Payments to MBEs Based on Audit Test	MBE Goal Achievement
Overall	25%	\$3,805,909	18.9%	\$3,969,470	19.8%
Women	10%	\$1,974,382	9.8%	\$2,102,435	10.5%
African American	10%	\$ 439,503	2.2%	\$ 475,011	2.4%
Other	None	\$1,392,024	6.9%	\$1,392,024	6.9%

Expenditures for construction and procurements through December 31, 2010 totaled \$56,536,173 for Hollywood Casino Perryville and \$20,082,971 for the Casino at Ocean Downs.

Recommendation 1

We recommend that

- a. GOMA ensure that it receives all licensee minority participation information applicable to each reporting period and that related attainment calculations are performed correctly, and**
- b. the SLC ensure the minority participation results it receives from GOMA are reasonably complete and accurate.**

² As previously noted, the Attorney General of Maryland has advised that the contractual provisions relating to these goals need to be amended.

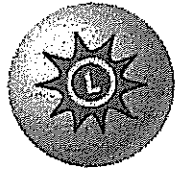
APPENDIX

MARYLAND LOTTERY

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Phone: 410-230-8800 • TTY users call Maryland Relay
www.mdlottery.com

Martin O'Malley, Governor • Stephen Martino, Director



November 3, 2011

Mr. Bruce A. Myers, CPA
Legislative Auditor
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Myers:

Enclosed is the Maryland State Lottery Agency's response to the audit report on the Video Lottery Operation Licenses Minority Business Participation.

If you have any questions or have require any additional information, please contact myself or Gina Smith, Deputy Director/CFO at 410-230-8790.

Sincerely,

Stephen L. Martino
Director

cc: J. Kirby Fowler, Jr., Chairman, State Lottery Commission
Gina M. Smith, Deputy Director/CFO, Maryland Lottery
Robert Howells, Procurement Director, Maryland Lottery

State Lottery Commission
Response to Audit Report on Video Lottery Operation Licenses Minority Business Participation

OLA Finding:

Finding 1

The licensees' minority participation data reported by the Governor's Office of Minority Affairs (GOMA) to the State Lottery Commission (SLC) contained certain inaccuracies that resulted in the understatement of minority participation.

OLA Recommendation:

We recommend that

- a. GOMA ensure that it receives all licensee minority participation information applicable to each reporting period and that related attainment calculations are performed correctly, and
- b. the SLC ensure that minority participation results it receives from GOMA are reasonably complete and accurate.

SLC Response:

The State Lottery Commission agrees to ensure that minority participation results it receives from GOMA are reasonably complete and accurate.



MARTIN O'MALLEY
Governor

ANTHONY G. BROWN
Lieutenant Governor

LUWANDA W. JENKINS
Special Secretary

November 8, 2011

Bruce A. Myers, CPA
Legislative Auditor
Office of Legislative Services-Room 1202
301 West Preston Street
Baltimore, MD 21201

Dear Mr. Myers,

Pursuant to the procedures set forth by the Joint Audit Committee Policy on Agency Response to Reports issued by the Office of Legislative Audits, I am pleased to provide a response to the Legislative Auditor's Draft review dated October 2011. The Governor's Office of Minority Affairs was audited on information provided on the attainment of minority business participation goals submitted to the State Lottery Commission (SLC) by video lottery operation licensees and the activities for Hollywood Casino-Perryville and the Ocean Downs Casino in Worcester County, Maryland for applicable activity through December 31, 2010. An electronic version of this response has been sent to your office via email at response@ola.state.md.us under the file name: (GOMA Response DLA-VLT Audit.doc).

As you are aware, the scope of this audit represents a new area of State activity, namely casino gaming and development of privately built and operated VLT facilities. Consequently, conducting VLT-related minority business compliance activities represents a first for GOMA. I wish to express my appreciation to your staff for their efforts in working with me and my staff on this audit review. While there was only (1) finding, I am pleased to provide a response as referenced on the following page of this letter.

If you or members of your staff have any questions or need additional information, please do not hesitate to contact me directly.

Sincerely,

Luwanda W. Jenkins,
Special Secretary

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**Governor's Office of Minority Affairs
Legislative Audit of Minority Business Participation on Video Lottery Licensee
Operations**

Response to Finding # 1

Finding 1

The licensees' minority participation data reported by the Governor's Office of Minority Affairs (GOMA) to the State Lottery Commission (SLC) contained certain inaccuracies that resulted in the understatements of minority participation.

Response:

- A. GOMA concurs with the auditor's findings and recommendation. It was noted that the inaccuracies were relatively minor and resulted because GOMA was not aware of certain payments to MBE firms by VLT licensees near the end of the reporting period which also contributed to an error made by our monitoring contractor.
- B. While GOMA concurs with the auditors' recommendation that all proof of MBE participation documentation is received during each reporting period and that related attainment calculations are performed correctly, it is important to note that GOMA and its contractor are tasked with essentially auditing private sector activity which is outside of the normal State Agency environment where financial data systems can be cross referenced by multiple state sources for validation and accuracy.
- C. It was also recommended that the SLC ensure that MBE participation results received from GOMA are reasonably complete and accurate. In support of this recommendation it would be helpful, moving forward if SLC would provide GOMA with the total VLT project costs for construction and operation that licensees provide in their initial proposal submission to obtain the VLT License. Having this information from the outset of project start-up will provide a starting point for GOMA's attainment calculations as MBE participation is derived by calculating the amount of payments for MBE work performed against the total project cost expenditures.

GOMA has already begun to explore gaining access to this information with Maryland Lottery, and the VLT Site Selection Commission and SLC.

AUDIT TEAM

Stephen C. Pease, CPA
Audit Manager

Terry S. Gibson
Senior Auditor