

Players' Pools: A Potential Drain

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Abstract

Indian casino operators have been seeking ways to operate Nevada style table games within existing laws. Under the 1988 Indian Gaming Regulatory Act, those casinos that do not have compacts with their states are permitted to operate only Class II gaming operations. In order to enable such casinos to operate table card games which are not backed by the casino, players' pools have evolved in which gaming wins are backed by the players themselves. The operation of players' pool gaming has been subject to a number of uncertainties, and it does expose the casinos to some unusual risks. Indian casinos need to be cognizant of these risks and must control their players' pool operations to avoid potential losses and to maintain the integrity of their operations.

The 1988 Indian Gaming Regulatory Act (IGRA) provided a turning point on how bingo halls and poker rooms are to be operated on Indian tribal lands. In order to operate games similar to Nevada style casino games (Class III gaming), the Indian tribes must seek compacts with their state government. However, some tribes who have had difficulty in obtaining compacts with their states, such as in California, have been able to operate Class II gaming under the provisions of IGRA.

Class II gaming, as defined in IGRA¹, does not include any "banking card games, including baccarat, chemin de fer, or blackjack." There has been considerable controversy over what constitutes banking card games under this definition. Many tribal casino operators have interpreted the provisions to mean only "house

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backed" card games similar to those offered in Nevada casinos. They continue to believe that they are able to offer table games, which are not backed, or "banked," by the casino. They have concluded that they can offer card games backed by the players themselves.

Player backed games developed in two ways. Initially, there were "player banked" games in which the players themselves acted as bankers to the game. This could be achieved either by one player agreeing to act as banker or by rotating the bank through participating players. More recently, the casinos have operated such games through the use of a "players' pool." In a players' pool, the casino acts as banker on behalf of all players in general, without participating in the win or loss from the game.

The classification of "player banked" games as Class II gaming has been challenged by the National Indian Gaming Commission². They regard this type of game as a banked game in which the banker happens also to be a player. They wish to classify this as Class III gaming. The logic of the Commission is based on the fact that there is essentially a Class III gaming operation being operated by the player banker within the auspices of the casino.

The Commission has not yet provided any formal ruling on "players' pool" card operations in which neither the casino nor an individual player acts as banker. This has resulted in an increased use of this type of arrangement for the operation of table games in Class II casinos. Irrespective of the legality of players' pools, this type of gaming has been expanding rapidly.

The financial interest of the casino in this type of operation comes from a rental rake that it takes for operating the tables and other incidental revenues generated by attracting customers to the casino.

The Nature of a Players' Pool

The concept of players' pool gaming has evolved and been modified over the last few years. With no specific regulations, there has been a great deal of confusion on the nature of such pools and how they should be operated. These uncertainties include questions of ownership of the funds in the pools, the appropriate accounting treatment for chip liabilities, the recognition of the various types of revenues and expenses relating to the pool, and the necessary internal control procedures, and the responsibilities of the casino toward such pools. These issues have become more important for the tribal casinos seeking progress in negotiating compacts with their states. They want to demonstrate that they have sound internal control procedures over the operation of the players' pools, and they want to ensure that they do not violate any existing laws and regulations. If they fail to show such responsible behavior, they will not be able to obtain the desired compact under IGRA regulations³.

With some variations, players' pools are being operated in the following manner. The casino provides the facility and the chips for players to play card

games in the casino. The chips cannot be backed by the casino because of the IGRA restrictions on house banked games. They are backed only by the net proceeds from the sale of chips to players participating in the pool. The available fund backing the chips that have been sold, net of any payouts to winners, is represented by a cash balance held in a trust account of the casino. This trust account represents the maximum potential payout to customers of the casino who play table games backed by a players' pool.

The financial interest of the casino in this type of operation comes from a rental rake that it takes for operating the tables and other incidental revenues generated by attracting customers to the casino. Although the casino has no direct interest in the size of the experienced win or loss, it does have a significant indirect interest in the available balance of the players' pool and the activity which it can generate from players participating in table games. The larger the available pool, the more likely the casino will be able to attract more customers. Few customers interested in playing table games will come to a casino with a small balance in the players' pool since they risk not being paid out if they win. This, in turn, affects other types of casino revenues from other games and services by reducing the number of patrons in the casino.

Risks to the Casino

The operation of a players' pool certainly provides an opportunity for tribal casinos to earn significant additional revenues. However, it does expose the casino to certain types of risks. Some of the risks are common to any casino operating table games or gaming with chips, but some risks are particular to operation of players' pool gaming.

At present, there is some confusion and misconception among Indian gaming operators about their Class II table game operations. They tend to regard players' pool operations as potential win/loss gaming on behalf of the house. That cannot be the case under the IGRA regulations. However, even though the casino does not have a direct financial interest in either the win or loss or in the cash balance in the pool, a significant amount of casino income is solely dependent on the table rake from operation of the games. The casino has an interest in ensuring that the pool is solvent and that table games are actively promoted and properly monitored.

Because the casino has no direct interest in the win or loss from players' pool operation, it might think that it has no responsibility over players' pool funds and chips with respect to proper internal control or accounting for the players pool cash and chips. However, the unique feature of a players' pool operation is that the casino is acting in a trustee relationship in respect of funds that it has received in forming a players' pool. The casino has a fiduciary duty to ensure that the funds are properly safeguarded and accounted for.

The casino also runs the risk that a pool may become insolvent and that it could inadvertently pay out amounts in excess of the balance that is, or should be, in the trust bank account. This can happen whenever the pool loses more than any previous accumulated win. Any such amount paid out is unlikely to be recoverable from the players and would represent a loss to the casino. The casino would also be in breach of Class II gaming under IGRA, since it will be deemed to have

underwritten the losses of the table game operations and banked the game. When this occurs, a Class II gaming operation effectively becomes a Class III operation.

The casino also bears the risk of loss in the event of theft or loss of the players' pool chips. Even though the chips do not represent a claim on the casino's funds, it is likely that the casino would have to make good such losses because of the fiduciary position in which it is acting towards the players' pool funds.

The legal obligations of the casino in this area are unclear. The ability to bring an action against a tribal casino in a court of law is difficult. This is because of the sovereign nation status of Indian tribes. Because of this status, the tribe or its employees, who act within tribal authority, are generally immune from suit for actions taken by them in connection with their operations on tribal land. The extent of this immunity from suit has been discussed and affirmed in the 1991 case of *Imperial Granite Company v Pala Band of Mission Indians*⁴.

Nonetheless, from a commercial standpoint, the casino also needs to ensure that players are fully aware of the nature of a players' pool fund and the risk that they are taking given the balance available in the pool. A player who is familiar with Class III gaming (for example, Nevada style casinos) is unlikely to realize that the chips that he or she has just purchased are different from those purchased in a Class III casino. In Class III gaming, all players' wins are fully guaranteed by the house. In Class II gaming, the extent of any win is only guaranteed by the amount available in the players' pool fund. Thus, a winner who found out after the fact that there were insufficient funds in the players' pool to meet their payout could be in for an unpleasant surprise. If the players' pool is insolvent, then the casino may not meet the extent of any deficiency from its own funds. The player, although possibly unaware of the regulations, loses out. That may have an adverse impact on the perception and reputation of the casino.

As states develop regulations, each casino must ensure that it is in compliance with those regulations, particularly if they are seeking a compact with their state in order to introduce full Class III gaming. As an example of the type of operational procedures to be followed, the proposed California Indian Gaming Internal Control Standards relating to player's pool operations is contained in the Appendix.

These standards have been developed by a group of the significant tribal casino operators in California, in conjunction with the Nevada - California Indian Gaming Association (NCIGA), as part of a concerted effort among the tribal casinos in those states to expedite the compact negotiation process with the State of California. Although observation of these standards is voluntary, most casinos are in the process of implementing such standards in their casinos for the reasons discussed earlier.

Internal Control Procedures

Unless the casino regards the players' pool as an asset of the house, there is a risk that these funds will not be subject to the same degree of accountability as its own funds. Because of the fiduciary relationship, the casino must ensure that the funds entrusted to it are properly accounted for and an adequate control system is in place to protect all of the items comprising the fund.

The trust bank account represents available cash for payment of wagers. The chip float held by players represents an existing claim on the trust bank account. The true size of the players' pool fund is the difference between the trust bank account and the chip float held by players. Therefore, it is important to keep track of both the trust bank account and the chip float which represents the difference between all chips issued and chips on hand.

In order to account for chip liabilities adequately, the casino must monitor and maintain accurate records for the purchase, issuance, and destruction of chips and must perform regular count down of chips on hand and chips in reserve. Even though the inventory of unused chips does not represent a claim on the casino's assets, the casino must ensure that these chips are properly safeguarded against loss, theft, or misuse. The reason for this is the fiduciary relationship that the casino has with the players' pool.

The casino must conspicuously post the current available cash balance in the players' pool so that players are aware of the fact that they may not be able to get payment of any winnings in excess of the pool.

To ensure that players' pool funds are properly controlled, the amount of the available funds must be continuously monitored. To do this, the casino will have to maintain separate trust records, in addition to its own house records, to account for players' pool funds. It must be able to identify wins, losses and outstanding chips relating

to the players' pool separately from other casino wins and losses and to segregate any liability for players' pool chips from other gaming chips which may be backed by the house.

Internal control procedures and cage accountability must be established to ensure that the casino does not inadvertently misuse or misdirect the players' pool fund. It is important not to commingle this fund with the casino's working cash in the cage. Any decrease or increase to the players' pool should be specifically identified and documented on a daily basis to leave a detailed audit trail.

Procedures must also be in place to ensure that the casino does not inadvertently use players' pool funds for its own benefit. For example, players' pool chips cannot be used for promotional purposes. The reason for this is that the casino cannot promote itself using funds that it does not own. If complementary chips are given, the casino must transfer the value of these chips from other casino funds to the players' pool as if it had purchased the chips from the players' pool.

The casino must also ensure that any chips given to dealers or other casino employees by way of tips are redeemed from players' pool funds and not from the general funds of the casino. If the tips are paid out of general casino funds, a transfer is necessary from the trust bank account to cover these amounts.

The casino must conspicuously post the current available cash balance in the players' pool so that players are aware of the fact that they may not be able to get payment of any winnings in excess of the pool. This should be updated on a daily

basis. The amount should disclose not only the existing trust cash balance but also the value of outstanding chip liabilities in case those players holding outstanding chips should cash their chips prior to another winner. In order to do this, the casino will have to implement an efficient and effective accounting system to determine these amounts on a timely basis.

Accounting Treatment

The question also arises as to what disclosure needs to be made of players' pool funds in the financial statements of the casino. Should the casino include an asset on its balance sheet for the amount held in the players' pool trust bank account and a liability for outstanding chips, together with an additional liability to unspecified future winners for the difference between these two amounts? The alternative is to omit both the trust bank account and the chip liability from the financial statements.

Except to the extent of uncashed chips held by players, the cash balance held in the players' pool is technically owned by nobody. That cash will only be owned when a future player wins and cashes in his or her winnings. There is no existing obligation of the casino to repay the trust cash except in that event so there is no liability. The liability is contingent on future wins by players.

Theoretically, it would seem inappropriate for the casino to include any asset or liability in its financial statements for these funds and obligations. It probably need not even recognize any contingency in the notes to the financial statements because the claims related to the players' pool are on the fund's cash and not on

the casino's own funds. The only obligation of the casino is to the extent that any shortfalls exist due to error or loss of players' pool chips.

However, the draft California guidelines contained in the Appendix explicitly state that the players' trust fund cash balance must be included as an asset in the casino's monthly financial statements. The obligation represented by outstanding chips and the remaining potential players' pool obligation must also be included as a current liability. This accounting treatment for outstanding chips is the same as that recommended for house backed chips by the AICPA in its casino accounting guidelines⁵.

It is probable that the California guidelines have taken this position to ensure that control is established by the casino over these "off balance sheet" assets and liabilities. The assets and potential liability will also be visible to regulators through this treatment. While the asset and liability might be included in any financial

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statements prepared for regulators, it is argued that they should be excluded from any annual external financial statements prepared by the casino for other purposes.

There is a further quirk in the treatment of the players' pool asset and liability if the casino financial statements are included in the financial statements of the tribe. The tribe will normally report under Government Accounting Standards Board rules. In that case, it could be argued that the players' pool funds should be included in the financial statements as a trust and agency fund.

Conclusion

The operation of players' pools in tribal casinos does provide a significant opportunity for them to generate additional revenue. Because of the lack of specific guidelines and regulations, players' pool operation has been difficult for the casino operators. At present, the law is unspecific and the means to achieve compliance are full of potential pitfalls. Operating such pools without clear understanding of their specific nature clearly adds more risks to operators.

Tribal casinos that are striving to maintain the integrity of their gaming and to comply with existing laws and regulations are in need of more guidelines on how to operate such pools. If a casino can exhibit proper control over Class II gaming operations, it will be easier, politically, for them to argue when negotiating their state compacts that they have the integrity and know how to operate Class III gaming.

End Notes

¹ IGRA Sec.4 (7) (b)

² National Indian Gaming Commission Bulletin 95-1. *All Banking Card games Fall Within Class III Gaming*. April 1995

³ IGRA Sec. 11 (4) (B) (3) and (4)

⁴ *Imperial Granite Company v Pala Band of Mission Indians et al.* 940 F. 2d 1269; 1991 U.S. App.

⁵ American Institute of Certified Public Accountants. *Audits of Casinos Audit and Accounting Guide*, New York: 1994

Appendix

EXTRACTS FROM CALIFORNIA INDIAN GAMING INTERNAL CONTROL STANDARDS FOR CLASS II CARD GAMING

SECTION III. – paragraph A (1) (d) of Gaming Integrity Standards

d. Banking of Poker and Other Non-House Banking Card Games

1. Other than the rake, the tribe, the casino, and the casino's employees shall receive no fee or any other form of compensation (other than customary and ordinary tips) from player bankers.
2. The banker shall be rotated among players at the table. The dealer shall periodically offer each player the opportunity to be the banker. The tribal government shall approve the procedures by which the games are played so that the rotation of the banker function among players at the table is promoted.
3. The house will establish a minimum amount of bankroll for the banker which promotes rotation of the banker function among players. The casino shall not license the suitability of bankers to perform that function at the casino.
4. In the event that no player chooses to bank the game, then the casino may establish a players bank trust. The purpose of the players bank trust is to assume all of the wager risk and reward that would otherwise be assumed by a player banker as if a player had actually banked the game. Other than the rake, the tribe, the casino and the casino's employees shall receive no fee or any other form of compensation from the players bank trust.
 - a. All deductions from the players bank trust must be for the payment of winning wagers.
 - b. The tribe shall conspicuously post the current available amount of the players bank trust. The posting shall be updated at least once a day.
 - c. The casino shall post a notice that if the players bank trust has insufficient funds to pay winning wagers, that the casino will not pay the winning wagers. The tribe, the casino and the casino's employees will not pay winning wagers from any source other than the players bank trust.

- d. The current available amount of the players bank trust shall be reflected as cash and a current liability in the gaming enterprises' month end financial statements.
- e. Increases and decreases to the players bank trust should be documented on a cashier's count sheet reconciliation form. The activity on the form should be evidenced by supporting documentation of all increases and decreases to the trust. The supporting documentation should be periodically audited by an employee who is independent of the poker and other non-house banking card games department.

23 - SECTION II. FINANCIAL AND INTERNAL CONTROL STANDARDS (Extract only)

9. PLAYERS JACKPOT POOL

- a. The tribe may make available to players the procedures and terms of players jackpot pools. This disclosure may include the method/rate for adding to the pool, any deductions from the pool that are not paid to players, and the method/rate for payouts to players. These procedures and terms should be approved by the tribal government or other designated tribal authority.
- b. The tribe shall conspicuously post the current available amount of the players jackpot pool. The posting shall be updated at least once a day.
- c. The current available amount of the players jackpot pool shall be reflected as cash and a current liability in the gaming enterprises' month end financial statements.
- d. Increases and decreases to the players jackpot pool should be documented on a cashier's count sheet reconciliation form. The activity on the form should be evidenced by supporting documentation of all increases and decreases to the pool. The supporting documentation should be periodically audited by an employee that is independent of the poker and other non-house banking card games department.

