

Players' Pool Slot Gaming: Fact And Fantasy

Charles Carslaw

E. J. Egghart

Abstract

Players pool gaming has existed in many jurisdictions in connection with card game operations. It has also being proposed for use in slot machine operations in jurisdictions where full Class III gaming is not fully legalized. Using a players' pool trust is a non-house-banked alternative for slot operation that has been proposed to allow Native American tribal casinos in some major states to operate their slot machines in a similar manner to Nevada style casinos. The purpose of establishing players' pool type gaming is to remove the house banking element from gaming that is essentially equivalent to Class III gaming operations and to make it equivalent to lottery type Class II gaming. The paper examines the problems of operation of a players' pool for slot operations and the accounting legal ramifications of using a players' pool.

Introduction

Using a players' pool trust is a non-house-banked alternative for the operation of electronic game machines that has been proposed for use in Native American tribal casinos in some major locations. The purpose of establishing players' pool type gaming is to remove the house banking element from gaming that is essentially equivalent to Class III gaming operations and to make it equivalent to lottery type Class II gaming. Class III gaming is defined in the Indian Gaming Regulatory Act¹. It includes the most common and profitable forms of house-banked gaming such as slot machines and blackjack type card games. Many states prohibit Class III gaming but, because they operate state lotteries, they are required to permit lottery-style gambling on Indian tribal lands. The use of players' pool trusts is the means through which Native American tribes can operate games similar to the most popu-

*Charles Carslaw,
Associate Professor,
University of Nevada,
Reno.*

*E.J. Egghart,
Egghart & Associates,
Reno, Nevada.*

lar Class III games because they operate them as lottery-style games. Use of a players' pool to bank tables games, such as blackjack, has been common for some time in card rooms and California tribal casinos. Following the successful passing of Proposition 5 by the electorate in that state, a draft tribal-State Compact² has been developed which requires players' pool gaming for both Class III type table games and electronic game machines. The purpose of this paper is to examine the ramifications of players' pool gaming for electronic game machines.

The nature of players' pool gaming

Players' pool gaming is distinguished from Nevada-style house banked gaming by the fact that a common pot, or "pool", is created by players' wagers and for which players compete. The pool is not owned by the house or by any player. Neither the house, nor any player, has a financial interest in the fund or the net win from the electronic gaming machines. The "players' pool" is equivalent to a trust fund whose beneficiaries are the players of the electronic gaming machines.

Either the tribal operator or the Tribe itself establishes a players' pool trust fund to account for winnings from the operation of electronic gaming machines. All winnings from the machines are paid into the players pool trust fund. The tribal operator may deduct from the funds in the player's pool trust a fixed rental or "rake" for play on the machines. The rake is pre-determined by the tribal operator.

On behalf of the trustee, the tribal operator has a fiduciary duty to pay winning players from available funds in the pool according to trust rules. If a pool becomes insolvent, the casino must refuse payment to subsequent winners. If they do not, the game becomes a Class III house banked game. This has ramifications for the amount that must be contained in the players' pool trust fund at all times, if the casino is not to run into the embarrassing situation of having to refuse to pay off a winning player. This is considered further below.

Basis for the rake

Under the proposed California statute, the rake may be based on a per-play, per-amount wagered or a time period of play basis for each electronic gaming machine. Most California operators have developed formulae based on the theoretical hold of individual machines (or the house hold percentage for a group of machines) to determine the necessary rental rake to ensure that the players' pool funds do not either build up or become depleted. The house rake is therefore structured to approximately equal the theoretical win from the electronic gaming machines. A small percentage reduction from the rake percentage is often provided for to ensure that the net win to the players' pool is greater than the theoretical hold. The intention of this is to insure that the pools do not become insolvent. This additional allocation to the pool is used to fund promotional prizes when the pool has excess funds. Under the proposed California statute, the only deductions, other than the rake, that are permitted to be taken from the pool are payouts to winners and other promotional prizes paid out relating to the machines. General operating expenses of the casino, including promotional advertising or machine maintenance, may not be charged to the pool.

Potential for manipulation of the size of the players' pool

In general, the casino operator will have the ability to manipulate the size of the players' pool balances. The following are some of the areas through which the funds in the pool can be manipulated. The casino operator has the ability to determine the rake percentage. The most common basis to determine the rake percentage is to use the theoretical hold from each of the machines or the overall house theoretical hold. This ensures that the expected value of the players' pool net win is zero unless variations from the hold percentage are used to provide for promotions. As long as the tribal operator has adequately seeded the pool, this should ensure a net positive fund in the players' pool trust to provide the ability to make payouts to customers.

Theoretically, the casino operator could change the rake on a daily basis to ensure that the amount required to be transferred to the players' pool trust fund on a daily basis is zero. The California requirement is only that the rake percentage must be determined in advance. However, it would seem that the percentage could be determined in advance on a daily basis to eliminate past excesses or shortfall. The casino could borrow or lend excesses or shortfalls contained in the pool to ensure that the pool has the minimum required liquid funds on hand and that all other funds are under the control of the casino operator. There are some constraints on this as discussed below. An alternative would be for the casino to "donate" funds to the pool whenever it is necessary. The casino also has considerable discretion over the way in which it allocates the cost of promotional prizes. If the pool has excess funds, the prizes can be charged to the pool. If there is a potential shortfall, the prizes can be charged against casino promotion expense.

This flexibility is undesirable if the casino wishes to argue that it is providing a true non-house banked game. Policies and procedures need to be implemented to ensure that players' pools are not artificially manipulated to such an extent that implications or accusations arise that house-banked gaming is not being operated.

The obligations of a video players' pool fund

The obligations of the video players' pool arise from several major sources. These are:

- Any accounts payable relating to purchase of promotional prizes;
- Obligations to the IRS for tax withholdings;
- Obligations relating to past progressive jackpots which are to be paid out over time;
- Provision for all displayed progressive jackpot liabilities;
- Provision for back up jackpots;
- Provision for promotional prize payouts;
- Provision for loans repayable to the casino operator; and
- Provision for amounts accumulated from win from all other non-progressive machine gaming.

Each of these obligations must be paid out from funds of the players' pool. In general, this will mean cash held by the players' pool. However, prizes in kind, rather than cash, which have been purchased by the pool, may also form part of the players' pool assets. There could also be some related accounts payable relating to the purchase of those assets. A sample balance sheet and operating statement, prepared under generally accepted accounting principles applicable to trust and agency funds of a tribal government for a players' pool trust fund, are contained in the Appendix. The extent of these potential liabilities and the means by which they are funded is a matter of concern both to the casino and to regulators who wish to ensure fair and honest gaming.

The minimum funding requirements for a video players' pool fund

The question of when a pool becomes insolvent and how much cash must be on hand in the pool to meet the obligations need to be considered. This is important because only the trust fund assets are available for the payment of winners and prizes. Supplementary reserve funds from the casino operator cannot be available to support any shortfalls in the players' pool trust assets since that amounts to house banking of the games.

From a legal standpoint, the pool would be considered insolvent if it could not pay its obligations when they fall due. This would seem to imply that whenever insufficient cash exists in the pool to meet a winning bet (or an account payable), the pool would be deemed insolvent. This basis is essentially a cash basis of accounting. It disregards the possibility that there could be future payments due.

The accounting point of view might be quite different because an accrual basis would be adopted. The pool would be insolvent if the assets at a point in time were insufficient to meet the accumulated liabilities as determined by generally accepted accounting principles. That means that all liabilities must be fully funded with existing assets. This implies that a much larger fund of cash must be set aside as the asset of the players' pool. The pool would refuse to make payouts when assets fall below the required level to meet other acknowledged obligations.

Typically, Nevada style casinos bankroll their obligations. The bankroll does not provide for all accumulated obligations such as the total of all outstanding progressive liabilities. The bankroll provides for the necessary funds to meet payments expected in the ordinary course of business. In the event that a combination of adverse effects occurs such as successive hits of material progressive liabilities, the Nevada style casinos would be able to access reserve bank accounts of the casino to meet the unexpected liability. Tribal casinos operating under a players' pool system do not have the luxury of being able to access other casino reserves when a combination of adverse events occurs. The only resources available to pay out winners are the accumulated funds of the players' pool. Other assets of the casino operator are not available to make up any shortfall. This raises the question of what minimum funds must a trustee maintain in the players' pool funds to meet obligations as they might arise. At a bare minimum, it is clear that the funds in the pool must be sufficient to meet the maximum displayed progressive jackpot. However, does the trustee have to have funds in the players' pool to meet all potential

accumulated jackpots and other liabilities of the pool? Can the obligations of the players' pool be bankrolled as in Nevada style casinos or must it be fully funded?

In their accounting to date, most players' pool trusts do not fund the full extent of these liabilities. In particular, they do not fund all of the progressive liability or the promotional liability as part of the pool. Some trusts fund a part of the liability from the pool and recognize the excess of the accumulated jackpot liability as a liability of the casino. Others have been building up the accumulated jackpot liability over time through set-asides from the house rake. None of these approaches is fully acceptable because the full liability for the progressive jackpot will be reported as an obligation of the players' pool. If genuine house-banked gaming exists, no actual or implied liability may be reported as an obligation of the casino in its financial statements because that would imply house support of the pool.

If casinos have to fund the players' pool trust to the full extent of all of the accumulated liabilities, it will mean that substantially more cash will have to exist in the pool over which the tribe and the casino do not have full control. Where the jackpot liability was on the balance sheet of the casino, it was backed by all of the assets on the casino's balance sheet. There is no requirement to fund the jackpot with cash alone although, naturally, sufficient liquidity is necessary to meet jackpot obligations as they arise. In the case of a players pool operation, that may not be appropriate. This problem becomes increasingly difficult to deal with when progressive jackpots are to be paid out over an extended period of time. For example, some jackpots are paid out over periods as long as twenty years. Future pool winnings cannot be used to pay past winners. This implies that the casino operator in a players' pool situation must immediately fund all jackpots with cash transfers to the players' pool trust fund. One solution suggested to minimize the impact of this funding problem has been to designate all the casino cage and vault bankroll as an asset of the players' pool rather than as an asset of the casino itself. This casino working fund has to be maintained in cash anyway for operational reasons so why not designate it as players' pool cash by "selling" the cage cash balance to the players' pool trust. That avoids tying up additional funds in bank accounts. All cage and vault cash can then be regarded as being an offset to the players' pool liability. Any excess liability will then be funded through other assets such as the trust bank account or investments.

Another approach to minimize the liability has been to suggest the purchase of insurance policies to fund the progressive jackpot liability and other payouts. This approach has some problems. If the casino buys the insurance policy, there could be an argument that the casino is backing the liability. It is then hedging that liability by selling it to another gambler in the form of the insurance company. If the trustees purchase the policy, they have to charge the casino cost of the policy because they are not allowed to charge insurance costs against the players' pool. Again the casino is suffering the cost of banking the game. Alternatively, the casino could buy the policy and then donate it to the players' pool trust. This again seems to be a fairly artificial distinction and the implication is still that the casino is banking the game.

The lack of a requirement to fully fund all obligations of the players' pool will inevitably lead to situations where a casino will have to refuse to pay out winners because the pool is insolvent, albeit temporarily. Failure to honor any such payouts by a casino will lead to considerable adverse publicity. The charge will also be brought that gaming in facilities operating under a players' pool system are not fair

to players in these circumstances. That is not the intent of the legislation but it is potentially a product of it.

To whom does the pool belong?

A further problem of the players' pool gaming concept is the question of who are the beneficiaries of the players' pool trust fund. Essentially, they are an unidentified class of patron who have participated in the gaming offered by the casino. Their comparative rights to any surplus existing in the players' pool are unclear. It could be based on their mere existence or the extent to which they have previously participated in the players' pool. This issue is further complicated by the question of how many players' pool trusts have to exist. There could be one players' pool trust for all gaming operations of the casino; one players pool trust for table games and one for electronic game machines; or separate players' pool trusts for each class of table game and each class of electronic gaming machine. In each case, the class of potential beneficiaries differs. The issue is important in two ways. First, where excess funds exist and it is intended to reduce those funds through a promotional payout, who can be the participants in the payout? Is it only past participants or can other new gamblers, or gamblers participating in other types of games, compete for the prize payout? Second, where the casino decides to terminate a players' pool or the casino becomes insolvent and ceases operation, the funds must be paid out to unspecified beneficiaries.

One way to resolve this is to allow players to enter their names in a players' register to evidence the fact that they are a part of the class of beneficiaries. This is an administrative headache for the casino and any person entering the casino could sign up in the register even if they do not play the machines. Another possible suggestion is to distribute the excess to members of any players' bonus club that may exist for the purpose of patron complimentaries or player tracking. This may identify the beneficiaries but it does not truly resolve the extent of any specified beneficiary's interest in the size of the accumulated players' pool. A third alternative, adopted by most state lotteries, is to designate some other trust fund as the beneficiary. For example, in California, any unclaimed lottery prizes revert to the California State Lottery Education Fund.

Player understanding of the players' pool concept

The problem of getting patrons to understand players' pool gaming for slot machines cannot be underestimated. The most common misconception will be that they are playing in a Nevada style environment in which they expect that the casino will meet all payouts. That misconception is hard to overcome and the economic damage that might result to the tribal casinos in the event that payouts are refused cannot be underestimated. The general perception of those people with some knowledge of players' pool slot machine gaming is that they are facing a more adverse game than the similar game in a Nevada style casino. In the case of players' pool table games, this is true. In players' pool table games, they are levied an additional cost, in the form of the rake, each time they make a table game bet. The odds are heavily stacked against them in this game from the point of view of pure play. They

would prefer a Nevada style blackjack game where no rake is required. For electronic gaming machines the situation is different. There is no apparent rake to the house at the time that they play the machine. They do not see their money being "pocketed" by the house in the way that they do with table games. The rake is unseen. If the house bases its rake on the theoretical hold of the machines, the player does not face an adverse game compared to Nevada style casinos. The net payout is purely determined on the theoretical hold of the machines and not on any additional rake requirements of the casino.

Trying to get these issues understood by patrons is a major challenge for tribal casinos. The perception is bound to be that they face a "less fair" game than that provided by Nevada style casinos and that is not the case if house hold percentages are equivalent. The players' pool concept is unlikely to be understood by patrons, and is most likely to be misunderstood because of the situation that exists for players' pool table games. Nonetheless, players need to be informed about the possibility that they might not be paid out on a winning wager because of the players' pool requirements. Explicit statement of that fact will reduce the adverse consequences in the event that the casino has to resort to that eventuality because it has an insolvent players' pool. It is to be hoped that this will never occur and it should not occur if management ensures proper accounting for the pool and a regular review of players' pool balances.

Accounting and audit of the pool

The existence of the players' pool raises some significant audit and accounting issues. The extent of the assets and liabilities held by the pool and the potential compliance requirements are not trivial. As shown in the Appendix, the pool will have significant cash funds and may also have significant investments and other assets. In order to ensure that obligations are likely to be covered from assets of the players' pool, management must ensure that they have, at least, daily information on the balance of the players' pool. That information must also be displayed clearly to patrons. The potential that a particularly adverse day could result in a negative players' pool balance must be considered in determining the amount of any seeding provided by the casino to the pool. It is also a reason why potential progressive jackpot liabilities should be funded within the pool. This requires a timely information system even in smaller casinos to avoid the possibility of violation of these requirements. Some small casinos do not drop on a daily basis. However, they are still required to meet these standards. One aspect of the NIGC Minimum Internal Control Standards³ is that they will be required to have some electronic data linkage for their slot operations. The electronic data processing system will, hopefully, enable them to determine their players' pool balance for slots even though they do not drop and perform revenue computations on a daily basis. This requirement will be onerous for these small casinos.

The impact of the players' pool on the financial statements of the casino also will be substantial. Because the players' pool fund is an independent trust fund, none of the assets and liabilities of the pool will appear in the financial statements of the casino operator. This will affect comparability of the financial statements between those operating under a players' pool system and those operating under a

house-banked system. Naturally, this comparability can be rectified if the casino financial statements are required to include summarized information on the players' pool operations by way of a note to the casino financial statements. This can be argued as a necessity under FAS 57 *Related Party Disclosures*⁴. The extent of those disclosures would include the existing assets of the fund and the extent of accumulated liabilities covered by those assets. Where operators bankroll, rather than fully fund, the full extent of accumulated liabilities of the players' pool, there will be an excess of apparent liabilities over assets. This becomes a contingent liability of the players' pool fund. It is not a contingent liability of the casino operator because that would imply house banking. Nevertheless, if bankrolling of the pool's liabilities is permitted, the extent of this unfunded liability is probably a material fact that needs to be known by users of both the casino and the pool's financial information.

All tribal casinos report under the standards required by the Government Accounting Standards Board since they are enterprise funds of the tribal government. The tribal casino enterprise fund will exclude the players' pool trust fund from its own financial statements required to be filed with the National Indian Gaming Commission under the Indian Gaming Regulatory Act. The activities of the players' pool fund will have to be reported in the tribal government financial statements in their trust and agency funds if the fund is established as a trust of the tribe to avoid potential taxation issues. This results in a considerable loss of information to the National Indian Gaming Commission as a primary regulator of tribal gaming. The impact of the existence of the players' pool trust will also have a significant impact on the audit of gaming operations. The players' pool trust fund does not form part of the casino operator's financial statements. It does not need to be audited as part of the gaming enterprise even though the extent of activities may be significant. Technically, the audit of the players' pool will be part of the audit of the Tribe's financial statements as a trust fund of the Tribe. However, unless the Tribe receives government grants that require an audit under the Single Audit Act⁵, there is a possibility that the operations of the trust fund will not need to be audited. If they are audited as part of the Tribe, there is a potential nine-month time lag in preparing the financial statements under that Act. This is in comparison to the National Indian Gaming Commission filing requirement of 120 days from the end of the financial year of the tribal casino operator.

This disparity is unsatisfactory, and it is clear that special audit requirements should be required to perform the audit of the players' pool within the same time frame as the audit of the casino. In addition, audit requirements are also required to ensure the integrity of operation of the players' pool to the same extent as that which would have occurred if the operations had been conducted in a house-banking casino operation. If the cage and vault assets are transferred to the players' pool, those operations could also now fall within the scope of the audit of the players' pool trust rather than the audit of the casino. Control issues surrounding the cage operation become the responsibility of the Trustees of the pool rather than the casino itself. There could be minimum internal control standards relating to cage and vault operations which now apply to the players' pool administrators rather than the casino. The trustees could, of course, contract out the cash operating function to the casino but there is no necessity to do so.

Wide area progressives

Another awkward area is that of wide area progressives. The sponsors of the progressives must also operate wide area progressives as players' pools. Generally, sponsors of wide area progressives expect to be paid a part of the net win from the operation of the progressive network. Rakes based on net win are not allowed under players' pool gaming. Sponsors will have to go through the same process as the tribal operators to determine the rake percentage based on games played that will give them exactly the same profit as they were getting when they were basing their percentage on net win. In addition, they may also have to immediately fund all jackpots which are to be paid over an extended period of time.

Conclusion

The requirement to operate Nevada style gaming under a players' pool system raises many potential problems. It is an artificial concept and the requirement has questionable logic to back it up. In addition, players' pool gaming in any form changes the perception of the gaming facilities provided by tribal gaming operators.

In the case of players' pool table games, the odds are changed such that they heavily favor the house since they can operate risk free table gaming. The house income is determined by the rake, not by any win or loss from table games play. Irrespective of whether a player makes or loses money the casino takes its cut in the form of the rake. The same is true for players' pool slot operations but not to the same extent. Operators can establish the rake to ensure that winnings based on the machines theoretical hold accrue to the house. However, they can refuse to cover losses when adverse events such as successive jackpot payouts occur which would result in a negative balance in the players' pool trust. The potential for abuse is obvious.

It would be more logical to ask why the tribal casinos should not offer slot machine gaming similar to that offered in Nevada style casinos when the end result is going to be the same irrespective of state legislative intervention. The net win to the tribal casinos and the net payoff to gamblers from slot machine operations with or without a players' pool trust will be essentially identical. The only difference is cost imposed by legislation to meet the players' pool requirements. Those costs are borne by the customer through reduced payout percentages and are avoidable. State regulations should be established to ensure that any gaming, including its own lottery gaming, is conducted in as fair a means as possible to insure integrity. Tribal casino operators will comply with stringent regulations because it is in their own interests to do so in exactly the same manner as the majority of casino operators in states such as Nevada willingly comply with the stringent requirements of their gaming control boards. The focus of the regulators should be on the solvency of the operators to meet all obligations as they fall due. They should not permit operators to default on obligations merely because of the technical requirements that a players' pool trust fund must be solvent to permit payout of gaming losses.

Endnotes

¹ *Indian Gaming Regulatory Act*. 25 U.S.C. § 2703(8).

² *The Tribal Government Gaming and Economic Self-Sufficiency Act of 1998*. California Government Code 98000-98012. (Note that this Act may become superseded if proposition 1A is approved by the California electorate in March 2000 and full Class III gaming is permitted on Tribal lands.)

³ *Minimum Internal Control Standards*. 25 CFR Part 542. National Indian Gaming Commission 1999.

⁴ *Disclosure of Related Party Transaction*. Statement of Financial Accounting Standards # 57. Financial Accounting Standards Board. Norwalk, Connecticut, 1994.

⁵ *The Single Audit Act Amendments of 1996*. Public Law 104-156.

Appendix

Balance Sheet XYZ Casino Players' Pool Trust Fund Of XYZ Tribal Government (Note 1) As of December 31, XXX

ASSETS		LIABILITIES	
Cash held in cage	XXX	Accounts payable	XXX
Cash in trust bank account	XXX	Due to IRS re withholding	XXX
		Due to casino re seed advances	XXX
		Liability for unpaid past progressives	XXX
Promotional prizes on hand	XXX	Available for players:	
		Jackpot liability	XXX
		Promotional prize liability	XXX
		Outstanding chip liability	XXX
		Net accumulated win	
		balance due	XXX
		Total obligation to players (Note 2)	XXX
Total Assets	XXX	Total Liabilities	XXX

**Statement of Changes in Net Assets
XYZ Casino Players' Pool Trust Fund of
XYZ Tribal Government (Note 1)
For the year ended December 31, XXX**

REVENUES

Net win from video devices (Note 3)	<u>XXX</u>
Less rental rake paid to casino enterprise	<u>XXX</u>
Net win transferred to players' pool	<u>XXX</u>

Less EXPENDITURES

Promotional payouts	<u>XXX</u>
Increase in jackpot and promotional liabilities	<u>XXX</u>
	<u>XXX</u>
Less unfunded increase in jackpot, promotional and other liabilities	<u>XXX</u>
	<u>XXX</u>

OTHER INCOME

Investment income	<u>XXX</u>
Net increase in players' pool balance	<u>XXX</u>
Available for players start of year	<u>XXX</u>
Available for players end of year (Note 2)	<u>XXX</u>

Note 1: These financial statements are prepared to conform with generally accepted accounting as applicable to governmental agencies since the players' pool trust fund is part of the trust and agency funds of the tribal government.

Note 2: Where a Tribe allows the players' pool trust to bankroll its players' pool liabilities, this balance sheet will be "truncated" and any excess liabilities to players fall off the balance sheet. These excess liabilities become potential contingent liabilities of the pool on the presumption that they will be payable from future winnings. They never become actual or contingent liabilities of the casino operator. (The idea of bankrolling the IRS liability is an interesting concept. The IRS might have other perceptions about that obligation!)

Note 3: Net win can be computed in various ways with respect to jackpot payouts. The definition used here is a "cash basis" one that includes paid jackpots from that machine but excludes amounts set aside for future progressives.

