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State Audit Finds Gaps in Colorado's First Year of Regulating Sports Betting

DENVER—The Colorado Office of the State Auditor (OSA) has issued a performance audit of the Division of Gaming's (Division) and the Colorado Limited Gaming Control Commission's (Commission) first year of regulating legalized sports betting in Colorado. In 2019, voters approved the legalization of sports betting in the state, allowing adults age 21 and older to place wagers in person at a licensed casino or online through a licensed Internet sports betting platform. Between May 1, 2020, and April 30, 2021, sports betting patrons wagered upwards of \$2.3 billion in Colorado on authorized sporting events, according to wager reports published by the Division.

Overall, the audit found that the Division and the Commission did not have effective processes to investigate sports betting operators and make sure they were qualified for temporary licensure, or to collect sufficient documentation to determine if sports betting operators' monthly tax filings were accurate.

Auditors found that, as of March 2022, 35 of the 39 licensed casinos and Internet sports betting operators held temporary licenses, which meant that these operators underwent a much more limited background investigation than they would have for a permanent license. However, the temporary licenses allowed them the same privileges as permanent licenses. For five of these operators, auditors found that the Division did not complete the minimum background investigative procedures required for a temporary license. For example, the Division did not have evidence that it had completed minimum required criminal history checks for three operators, inquiries about operators' regulatory history in other gaming jurisdictions for two operators, or analysis of three operators' financial stability and capability to carry out their planned business operations.

“Incomplete investigations increase the risk that the Commission is making temporary licensing decisions that are not fully supported or defensible,” said Jenny Atchley, Audit Manager.

The State imposes a 10 percent tax on the net sports betting proceeds reported by operators, with sports betting tax revenues distributed to several beneficiaries. In Fiscal Year 2021, sports betting tax revenue distributions to these recipients totaled about \$8.6 million. Sports betting operators' monthly wager activity is a key data point for determining tax liabilities. Auditors sampled 22 sports betting tax filings from May 2020 through April 2021 and found wide variation between the amount of wagering activity that operators reported after each gaming day and the totals they reported in their monthly tax filings. Variances ranged from one operator that reported \$1.4 million more in net sports betting proceeds in its daily wager reports compared to its monthly tax filing, to an operator that reported \$1 million less in net sports betting proceeds in its daily wager reports compared to its monthly tax filing. The Division does not require sports betting operators to provide documentation to substantiate changes to reported wager activity, even though these changes have a direct impact on the amount of sports betting taxes paid.

Auditors also identified a potential policy issue for the General Assembly to consider. "Free bets" are bets made by patrons using non-cashable vouchers, coupons, electronic credits or electronic promotions provided by sports betting operators. Statute allows sports betting operators to deduct free bets when calculating their net sports betting proceeds, which can result in operating losses. However, current Commission rules go a step further by allowing operators to carry forward monthly operating losses, thereby reducing their future sports betting tax liability. Auditors questioned whether this practice aligns with voters' and legislative intent when sports betting was legalized. Auditors' analysis of the 324 tax filings reported from May 2020 through April 2021 showed that if operators had not been allowed to deduct and carry forward operating losses, the State would have collected an additional \$706,000 in sports betting tax revenues during the first year.

State law requires the OSA to audit the Sports Betting Fund at least once before May 1, 2022, and at least every 5 years thereafter. Completed in April 2022, this audit was the OSA's first, and it made 10 recommendations (including recommendation subparts) for improvements. The full audit report is available online at www.colorado.gov/auditor.

About the Office of the State Auditor

Under the direction of the State Auditor, the OSA's nonpartisan, professional staff promote government accountability by conducting independent performance, financial, and IT audits and evaluations of state agencies, departments, and institutions of higher education; conducting independent evaluations of the State's tax expenditures (e.g., credits, exemptions, deductions); tracking about 4,000 Colorado local governments for compliance with the Local Government Audit Law; and operating a statewide fraud reporting hotline.

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