

Office address: Maison des Venelles
Venelles des Gaudions
Alderney
Channel Islands
GY9 3TW

Postal Address: PO Box 15
Alderney
Channel Islands
GY9 3HT

Telephone number: +44 (0)1481 823967

Facsimile number: +44 (0)1481 823978

Chief Executive Officer: André Wilsenach
andre@gamblingcontrol.org

General enquiries: Chrissie McCulloch
(Office Administrator)
chrissie@gamblingcontrol.org

Inspectorate: Norman MacKillop
(Senior Regulatory Inspector)
norman@gamblingcontrol.org

Phil Newman
(Senior Technical Inspector)
phil@gamblingcontrol.org

Michael Ellen
(Senior Financial Inspector)
michael@gamblingcontrol.org

Website address: www.gamblingcontrol.org



ALDERNEY GAMBLING CONTROL COMMISSION

15 April 2005

Chairman
Policy and Finance Committee
States of Alderney
Queen Elizabeth II Street
Alderney
GY9 3AA

Dear Colonel Walter

I have pleasure in presenting the Report of the Alderney Gambling Control Commission for the period 1 January to 31 December 2004.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'John Godfrey', written over a faint, illegible background.

John Godfrey
Chairman

Members: John Godfrey (Chairman), Raymond Birdseye, John Buggy, John Clitheroe

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Mission Statement

To maintain the integrity of
the electronic gambling industry in Alderney.



OBJECTIVES

To protect the reputation of Alderney as a first tier jurisdiction by seeking to ensure that:

- all electronic gambling on Alderney is conducted honestly and fairly;
- the funding, management and operation of electronic gambling on Alderney remains free from criminal influence; and
- electronic gambling is regulated and monitored so as to protect the interests of the public.

Chairman's Statement

I am glad to report that, in 2004, Alderney has maintained its position as the pre-eminent jurisdiction worldwide for interactive gambling companies wishing to operate within a fully regulated environment.

It has been a busy year. The number of licences issued by the Commission increased from ten to fourteen during the year and, in addition to the work involved in the issue of these new licenses, 2004 was the first year in which all of our active licence holders were subjected to audit. The range and scope of the activities of Commission staff is outlined in the report, in particular in the sections between pages 9 and 14.

I therefore wish to start by congratulating and thanking all of our staff and, in particular, our Chief Executive, André Wilsenach, for their energetic and skilled contribution to a successful year.

The purpose of the legislation permitting e-gambling on Alderney is to generate economic benefit for the island. I am therefore particularly glad to report a satisfactory year for the finances of the Commission.

All of our assets belong to the States of Alderney. At 31 December 2004, the net assets of the Commission stood at £1,345,925 and it is relevant to mention that this value has been achieved without any investment of public funds. Our cash reserves alone generated nearly £40,000 of interest during the year to contribute to a total surplus of income over expenditure of £767,794 compared with £535,502 in 2003.

Some assets are needed for the continuing activities of the Commission and a significant proportion of our cash reserves is earmarked to cover the risk of a possible downturn in activity but, after taking a prudent view of the cash reserves needed to meet this risk, I believe that rather more than £500,000 is now surplus to the needs of the Commission.

In financial terms, the progress made since the Commission was established just four years ago has been a good deal better than expected, but I am even more pleased by the reputation that Alderney has earned as the leading regulator of e-gambling.

However, as I have mentioned in previous years, we face world wide competition. Our licence holders could, if they wished, operate from any of a large

number of alternative jurisdictions. While maintaining the highest standards of regulation, we have to ensure that Alderney remains an attractive place to base an e-gambling business. The review of legislation carried out towards the end of the year, which is described on page 8 of the report, is therefore the most significant activity of the Commission in 2004. The proposed changes were developed on the basis of extensive research and consultation and have been welcomed by both existing and prospective licence holders.

One of these changes will bring to an end the requirement for licence holders to have a nominee on the island. We have been able to approve some excellent appointments of nominees over the past few years and I wish to thank all of the current nominees both for agreeing to serve and for their generous recognition that the changed nature of the e-gambling businesses in Alderney makes the proposed change appropriate. We are very conscious of the desirability of the creation of jobs on the island, but our dominant consideration must be the objective of making Alderney a pre-eminently attractive jurisdiction for e-gambling.

The increased number of licence holders has called for some additional staff at the Commission, which itself constitutes a centre of economic activity, and one of our licence holders employs twelve staff on the island, but the contribution to employment is modest, and likely to remain so. It is a mark of how events can move forward in unexpected ways to remember that one of the principal concerns when legislation to permit e-gaming was introduced was that the influx of staff would put unacceptable pressure on the available accommodation.

However, in most respects, we have been more successful than we expected when we took the decision to move into the licensing of interactive gaming. We are currently regarded as the leading regulator in the field and our financial position is strong. Much of this success is attributable to the support we have had from the Policy and Finance Committee of the States of Alderney and from our legal adviser, Richard McMahon; and my fellow Commissioners bring wide experience, judgement and wisdom to our discussions. I am very grateful to them all.

John Godfrey, Chairman

The Commission

The Commission is independent and non-political. It includes people with experience of gaming, regulation and licensing. The Commissioners are:



John Godfrey, Chairman of the Commission, is a specialist in gambling regulation. He has been re-appointed as Chairman of the Commission for a second term of office in May 2004. He was consulting accountant to the Gaming Board for Great Britain for almost 30 years and an adviser to the Government of The Bahamas. For much of this period of time, John was also an expert witness for the Metropolitan Police.



Raymond Birdseye held the position of President of Barclays Bank Corporate Division in North America for a number of years before joining the Board of the Civil Aviation Authority (CAA) as financial regulator for United Kingdom Airline Companies and Air Travel Organisers Licences. Additionally, he was Chairman of the CAA Audit Committee and several other committees.



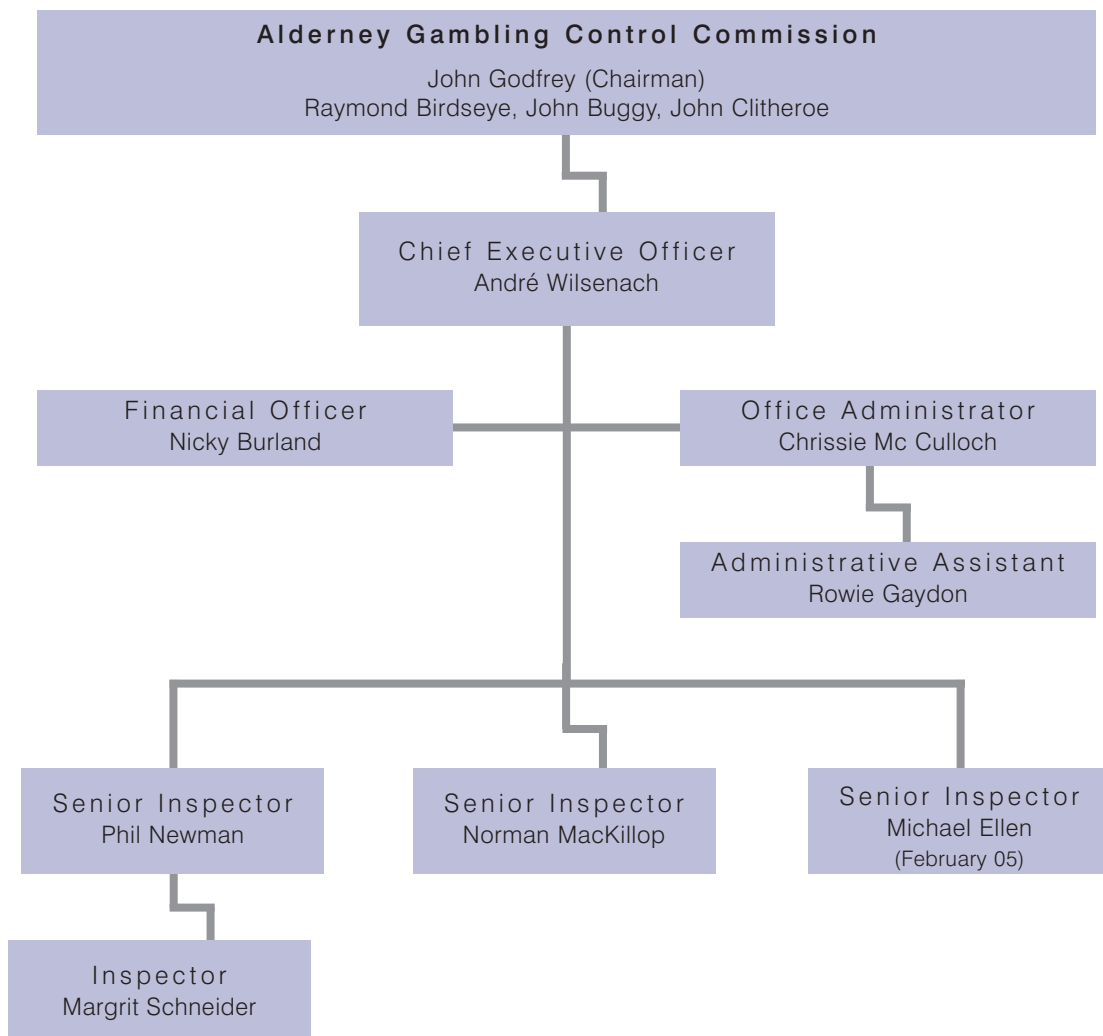
John Clitheroe was a senior partner of Kingsley Napley, a prominent firm of London solicitors where, in addition to a distinguished career in litigation, he was an expert on licensing law. He is now an international consultant and lecturer on gambling.



John Buggy is the former Chief Executive Officer of Alderney Electricity Limited. As a former Chairman of the Policy and Finance Committee of the States of Alderney, he was closely involved in the early legislation to permit electronic betting on the island. As an Alderney resident he understands the local social and economic needs of the Alderney people.



André Wilsenach, the Chief Executive Officer, has a long history in gambling regulation. He served on both the national and provincial gambling boards in South Africa. Subsequently, he became the first CEO of a South African company which was established to render electronic monitoring services to the National Gambling Board of South Africa. He is a member of the Steering Committee of the International Association of Gaming Regulators and an affiliated member of the International Masters of Gaming Law.



The Commission

The Technical Inspectorate consists of **Phil Newman** (Senior Inspector) who has over twenty years of experience in networking and systems administration, and **Margrit Schneider** (Inspector) who was appointed in December 2003. Margrit is a software and systems engineer with experience in the whole lifecycle of software development, software testing, installation and support within a commercial environment.

The Regulatory Inspector **Norman MacKillop** (Senior Inspector) was a senior police officer specialising in organised and serious crimes for more than 20 years. He also practised as a Barrister for five years and before his appointment in 2003 worked for the Commission as a Consultant.

In December the Commission agreed to establish a new post for a Senior Financial Inspector to perform financial and forensic accounting functions and to assist with the ongoing review of the financial performance of licensees. **Michael Ellen**, a qualified accountant with extensive experience in the financial services industry, was appointed in February 2005.

The Administrative Staff includes **Chrissie McCulloch** (Office Administrator), **Nicky Burland** (Financial Officer) and **Rowie Gaydon** (Administrative Assistant) who joined in October 2004.



From left to right: Rowie Gaydon, Nicky Burland, Chrissie McCulloch, André Wilsenach (standing), Margrit Schneider, Norman MacKillop and Phil Newman.

Approach to regulation

The main objective of the Commission is to provide a regulatory environment that meets 'world-class' standards and thereby both protects the reputation of Alderney and attracts 'world-class' operators. This is not what is typically offered elsewhere. There are currently about two thousand internet gambling sites which are owned by approximately 350 businesses operating from jurisdictions other than Alderney, of which only a handful are regulated in any meaningful way.

The Commission has therefore positioned itself to offer a regulatory environment that is likely to attract the relatively small number of operators who seek a comprehensive and tightly controlled regime. These are for the most part the major gambling operators who have brands that they wish to protect. In the longer term, it is these substantial and high quality companies that are likely to dominate the world-wide internet gambling business. They are also the companies likely to conduct their businesses in a way that is consistent with the standing of Alderney and Guernsey as financial centres.

The Commission liaises with other international regulatory bodies such as the Gaming Board for Great Britain, the Nevada Gaming Control Board and the New Jersey Division of Gaming Enforcement, mainly in connection with probity and due diligence investigations. The Commission is supported by its three approved independent testing authorities, all of which are specialist companies in the field of testing gambling equipment and specifically gaming systems and software. These are Global Gaming Systems (GGS), Bellamy, MoneyPENNY and Millar (BMM) and Technical Systems Testing (TST).

The Commission also maintains links with bodies such as Guernsey Financial Services Commission (GFSC), the Guernsey Financial Intelligence Services, Credit Bureaus and the Guernsey Police and Dixon Wilson, a London-based firm of accountants, with particular experience in the gambling field.



Since its inception the Commission has enjoyed the support of the Law Officers of the Crown for legal advice and, in particular, that of Advocate Richard McMahon, the legal draftsman and advisor to the States of Alderney.

The Commission seeks to be commercially realistic and sensitive to the operational needs of the industry. In 2002, it promoted the establishment of the AGLF (Alderney Gambling Licensees Forum). The forum, consisting of all licensees, meets on a quarterly basis to discuss matters of common interest, for example, system testing, control systems and legislation. At the last meeting, in December 2004, Nick Rust Managing Director of SkyBet succeeded Paul Mathews, Managing Director of WagerWorks as Chairman of the forum.

It is important that potential licensees know what is required of them before they consider an application for a licence. Accordingly, the laws, guidelines and requirements applicable to the application process and operation of a licence are comprehensive and detailed. These laws and regulations are set out on the Commission's website.

A fuller statement of the objectives of the Commission and of its approach towards regulating interactive gambling is set out in Appendix A.

Regulatory Framework

During the year the Commission has conducted a review of the interactive gambling legislation in Alderney. Electronic gambling is a rapidly developing business and the Commission recognises that it is important for both the Island and the operators wishing to conduct their businesses from Alderney, for the legislative framework to be modified from time to time.

The following changes have been approved in principle by the Policy and Finance Committee of the States of Alderney:

- the enforceability of gambling contracts, so that that gambling contracts made as a result of lawful interactive gambling in Alderney will no longer be void and unenforceable;
- the replacement of the current Ordinances covering two separate, but related licensing regimes (i.e. interactive gaming and electronic betting) with a single eGambling Ordinance;
- subordinate regulations may be made by the Commission to support this single eGambling Ordinance;
- applications for eGambling licences will be made by corporate entities and not individuals;
- more direct control over software suppliers and other service providers will be exercised by introducing a form of certification;
- key individuals will be approved personally, rather than through the relevant corporate licensee;
- it will no longer be necessary for licence holders to appoint a nominee to be present on the island on their behalf;
- responsibility for seeking approval for gambling premises will be transferred from the licensee to the person who is in control of the premises where gambling equipment is hosted;
- licences will be issued without the need for periodic renewals;

- licence holders will be required to meet the direct cost of compliance; and
- the cost of licences will be reviewed in order to make the above changes cost neutral.

The Commission discussed these proposals with the Policy and Finance Committee in October and consulted with the Alderney Gambling Licensees Forum in November. Following this consultation process, the Policy and Finance Committee has instructed the Law Officers to proceed with the drafting of a new eGambling Ordinance, which is expected to be tabled towards the end of the first quarter of 2005.

An outline of the current regulatory framework is set out in Appendix B.



"The Policy and Finance Committee is very conscious that the ability to respond quickly to the need for ongoing changes to gambling legislation is essential to a prosperous interactive gambling industry and the successful regulation thereof."

Col. Peter Walter M. B. E.
Chairman, Policy and Finance Committee, States of Alderney.

Following discussions between the States of Alderney and the States of Guernsey in 2003, the Alderney Internet Gambling (Temporary Relocation) Ordinance, 2004 was introduced. The Ordinance makes it lawful for Alderney licensees to conduct their games in Guernsey under their Alderney licences should an event or incident outside the control of the licensee make it impossible for licensees to conduct their games in Alderney.

Activities during 2004

Investigations and licensing

During the year under review, the Commission conducted investigations into the affairs of six applicants and issued licenses to the following companies.

- WagerWorks (Alderney) 4 Limited;
- Blue Square Gaming (Alderney) Limited;
- WagerWorks (Alderney) 5 Limited;
- Cantor Casino (Alderney) Limited;
- Paddy Power (Alderney) Limited; and
- Samvo International Limited

In deciding whether to licence the above companies, the Commission also considered the suitability of the following two business associates:

- Fremantle Media North America Inc., a business associate of WagerWorks (Alderney) 4 Limited; and
- Virgin Games Ltd, a business associate of WagerWorks (Alderney) 5 Limited.

These companies have made their white labels available to WAL 4 and WAL 5 respectively, which are responsible for the management and operation of these casinos.

Certificates of Prior Approval were issued to the following five companies:

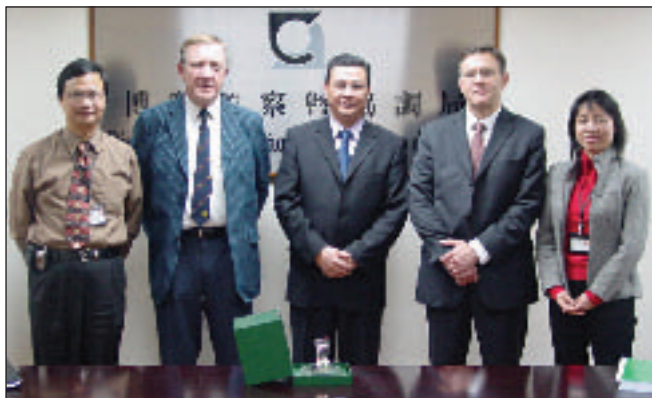
- Tribeca Tables Software LLC;
- Gaming & Entertainment Group Inc;
- Secure G Holdings Ltd;
- Chartwell Technology Ltd; and
- Orbis Technology Ltd.

These companies have been approved by the Commission and found suitable to be associated with any of the Commission's licensees. Certificate holders providing software to Alderney licensees are required to apply to the Commission for approval of their gaming equipment and, if approved, a description of the relevant equipment will be endorsed on the certificate.

A full list of licensees, their trading names and gaming software providers is set out at Appendix C. WagerWorks (Alderney) 3 Limited surrendered its licence in November of 2004. The licence was surrendered following a decision by Paddy Power to obtain a licence in its own right with a view to taking full control of its operations, which were previously managed by WagerWorks. Following the decision of Harrah's Online Ltd. to cease operations in October, GameLogic did not apply to renew its Certificate of Prior Approval.

During the Commission's investigations, officers of the Commission conducted enquiries and liaised with the following regulatory and law enforcement bodies:

- Guernsey Police;
- Guernsey Financial Services Commission;
- Gaming Board for Great Britain;
- Nevada Gaming Control Board;
- New Jersey Division of Gaming Enforcement; and
- The Macau Gaming Inspection and Coordination Bureau



Members of the AGCC staff visiting the offices of the Macau Gaming Inspection and Coordination Bureau.

Comprehensive reports were prepared on each of the applicants to assist the Commission in determining whether they were 'fit and proper' to be granted a licence. Consideration of the 'fit and proper' test is essentially a question of personal and corporate character. The issue is whether or not the applicant is likely to run a highly regulated business within both the spirit and letter of the restrictions imposed upon it. An investigation of the business history and relevant experience of the applicant, associated principals and business associates involved is an essential feature of this aspect of the Commission's enquiries, together with an assessment of the comments and opinions of independent third parties who have had dealings with them.

These reports normally deal with the following matters:

- the history and general suitability of the applicant;
- the financial stability of the applicant;
- the source and adequacy of funding for the Alderney project;
- the executive associates of the applicant, as to whether they are 'fit and proper' persons to be associated with the licensee's operations;
- the key personnel, as to whether they are 'fit and proper' persons to act in their stated positions and to be granted key personnel licences; and
- the nominee, as to whether he or she is a 'fit and proper' person to carry out the functions and duties required by the Ordinance.

The Commission met with all new licensees during 2004, with the exception of Samvo International Limited whose licence was issued in December.

Compliance

Launching of Casino Sites

During the year under review the following six interactive casino sites have been launched:

- WagerWorks (Alderney) 3 Limited (www.paddypowercasino.com)
- Harrah's Online Limited (www.luckyme.co.uk)
- WagerWorks (Alderney) 4 Limited (www.thepriceisrightgames.com)
- WagerWorks (Alderney) 5 Limited (www.virgingames.com)
- Blue Square Gaming (Alderney) Limited (www.bluesqcasino.com)
- Paddy Power (Alderney) Limited (www.paddypowercasino.com)

Prior to the launching of a site the Commission is required to approve the following:

- a Control System Submission in which is detailed all internal controls and operating procedures;
- the interactive gaming equipment that the licensee proposes to use;
- the interactive games that will be made available for play by the operator;
- the premises at which the games will be conducted; and
- the external auditors of the licensee.

In the approval process the Commission relies upon reports produced by members of its own staff assisted by Dixon Wilson in respect of the Control System Submission and also the relevant testing authorities who produce software certification reports in respect of the gaming equipment and games to be made available for play.

Changes to live Interactive Gaming Systems (IGS)

The Commission requires licensees to obtain the approval of the Commission for changes to their live IGS. During 2004 the Commission received 655 such requests. These requests fall into the following categories:

- Promotional text and graphics 7%
- New games and features 9%
- “Bug” fixes and patches 29%
- Maintenance 29%
- System infrastructure changes 8%
- Configuration 18%

Only about 10 % of all changes have any significant impact on either the outcome of the games or the security of the systems used. As previously reported, a revised approach towards change requests was implemented towards the latter part of 2003, which grants prior general approval for defined low-risk changes and the evaluation of defined medium and high-risk changes by the Commission. During 2004 this approach was implemented successfully. Depending upon the complexity of the change the Commission may:

- approve the change and allow the modification to be implemented; or
- request further information such as software supplier change proposals, specifications or test reports or the opinion of an independent approved testing facility (ATF) before making a decision; and/or
- in a relatively small number of cases, direct that the change be evaluated by the licensee’s preferred ATF before approval is granted.

In dealing with an application for the approval of changes, the procedure followed is specific to each operation and is dependent upon the software used. In all cases however the following items are required to be in place prior to the procedure being undertaken:

- the baseline certification of the IGS by an ATF;
- the classification of the various components of the IGS according to the risk to game outcome and system security by an ATF, in consultation with the Commission, the licensee and its software developer;

- the establishment and approval by the Commission of an auditable change management process as part of the licensee’s control system submission; and
- the availability of a facility to the Commission to verify checksums on demand.

Compliance Inspections

The Commission conducts annual compliance inspections in respect of the licensee’s operations to ensure that they comply with the controls and procedures contained in their control system submissions. The main focus of these inspections is as follows:

- review of post “go-live” recommendations or temporary dispensations;
- adherence to approved control system submission;
- adherence to the conditions of the licence;
- adherence to the provisions of the Ordinance;
- review of security policies and procedures;
- review of audited accounts and monthly financial reports; and
- software verification.

A complete checklist is normally prepared prior to the inspection which is based upon those areas of the approved control systems that are considered to present a risk. Examples of areas that are typically reviewed during the compliance review are contained in Appendix D.

During the year under review inspections were carried out at the following licensee’s premises;

- Rank Interactive Gaming - London;
- Blue Square Gaming - London;
- WagerWorks UK - Leamington Spa and London;
- WagerWorks Inc. - San Francisco;
- GameLogic - Boston;
- Ritz Club Online - London;
- CryptoLogic - Toronto; and
- WagerLogic - London.

The compliance inspection programme is risk based. Therefore, the focus of subsequent inspections is based on the compliance levels found during previous inspections.

Assessment of quarterly reports

In addition to annual compliance inspections, the Commission reviews, on a quarterly basis, the operational and financial reports of all licensees to ensure that the licensees operate their business in accordance with both the conditions of the licence and their control system submissions. The items that are typically addressed are contained in Appendix D.

Ad Hoc Activities

The Commission met on fourteen days during 2004 to deal with licensing and compliance issues in addition to routine business matters such as:

- ongoing amendments to legislation;
- staffing and recruitment;
- jurisdictional developments;
- disaster recovery facilities;
- budgets and funding of the Commission;
- UK Gambling Bill; and
- strategic planning.

The Commission has met twice during the year with the Policy and Finance Committee; in May to table the 2003 Annual Report and in October to submit its budget for 2005.



Mr John Godfrey, Chairman of the Commission presents the 2003 Annual Report to Col. Peter Walter, Chairman of the Policy and Finance Committee of the States of Alderney.

The Commission attaches particular importance to its annual meetings with individual licensees. During these meetings issues such as business plans and opportunities and constraints facing licensees are discussed.

The Commission also met with the Alderney Gambling Licensees Forum on two occasions during the year under review when the following items were discussed:

- their ability to introduce poker and jackpot games;
- disaster recovery and business continuity;
- the UK position on advertising; and
- amendments to the Alderney gambling legislation.

Members of the Commission and the Chief Executive Officer have made presentations or participated in panel discussions at the following international conferences and meetings:

- Global Interactive Gaming Summit and Exhibition;
- Gaming Regulators European Forum;
- European I-Gaming Congress and Exhibition;
- International Association of Gaming Regulators Conference;
- International Association of Gaming Regulators Working Group;
- Online Gambling Summer Retreat;
- Small Jurisdictions Seminar;
- Future of Remote Gambling Conference;
- Virtual Gaming Conference;
- International Masters of Gaming Law Conference;
- Interactive Gaming, Gambling and Betting Association Conference;
- Mobile Gambling Forum;
- e-10 Gaming Conference; and
- Casino Affiliates Conference.

The Commission received a visit from the Nevada Gambling Control Board as part of an investigation conducted into an applicant for a key employment licence in Nevada.

During a meeting of the International Association of Gambling Regulators in 2003, the Alderney Commission was asked to take the lead in establishing a Working Group on interactive gambling which would identify and comment on regulatory issues. During 2004 the Working Group held two meetings, which were chaired by John Godfrey.

During the course of 2004 six media statements were issued and Mr John Clitheroe reviewed and revised the chapter on Alderney for the seventh edition of the Interactive Gambling Report, published by the River City Group.

Following a decision by the UK Government to provide in the Gambling Bill for a 'white list' of non- EEA countries that may qualify for advertising of gambling services in the UK, the Commission, through the offices of the President of Alderney, formally approached the Secretary of State of the Department of Culture Media and Sport with a request that Alderney, in view of its standard of regulation, be considered for white-listing. Although the Secretary of State has indicated that positive consideration will be given to Alderney's request, a final decision will not be taken until such time as the criteria for white-listing have been determined. In putting forward Alderney's position, the Chairman and CEO met with the following parties:

- The Department of Constitutional Affairs (Devolution and Crown Dependencies Division);
- The Department of Culture Media and Sport; and
- Mr John Greenway, Chairman of the Parliamentary Scrutiny Committee;

Early in 2004, the Advisory and Finance Committee of the States of Guernsey, commissioned an independent review of interactive gambling on Alderney to:

- outline the nature of the e-Gaming sector and how the business conducted/envisaged by Alderney fits into its development;
- consider the economic impact of the e-Gaming sector on the Alderney economy; and
- consider if there is a risk of any potential impact of e-Gaming on the wider reputation of the Bailiwick.

This 47 page report was published in March 2004 and concludes that *"...in our consideration the e-Gaming industry in Alderney does not pose any particular reputational threats to the Bailiwick that could "spill over" into the financial services sector"*

Staffing

Miss Margrit Schneider who was recruited during the previous year commenced her duties as Technical Inspector in February 2004. Towards the middle of the year, the Commission approved the appointment of an Administrative Assistant on a part-time basis. Mrs Rowie Gaydon was appointed to this position in October.

Considering the growth in the number of licensees in Alderney, the Commission decided at the end of 2004 to establish the post of Senior Financial Inspector to perform financial and forensic accounting functions and to assist with the ongoing review of the financial performance of licensees. Mr Michael Ellen, a qualified accountant with extensive experience in the financial services industry, was appointed in February 2005.

The Commission introduced a Group Medical Insurance Scheme for all staff during 2004. Various schemes were investigated and it was decided that the private health cover should be through BCWA Healthcare.

Finances

Income and expenditure

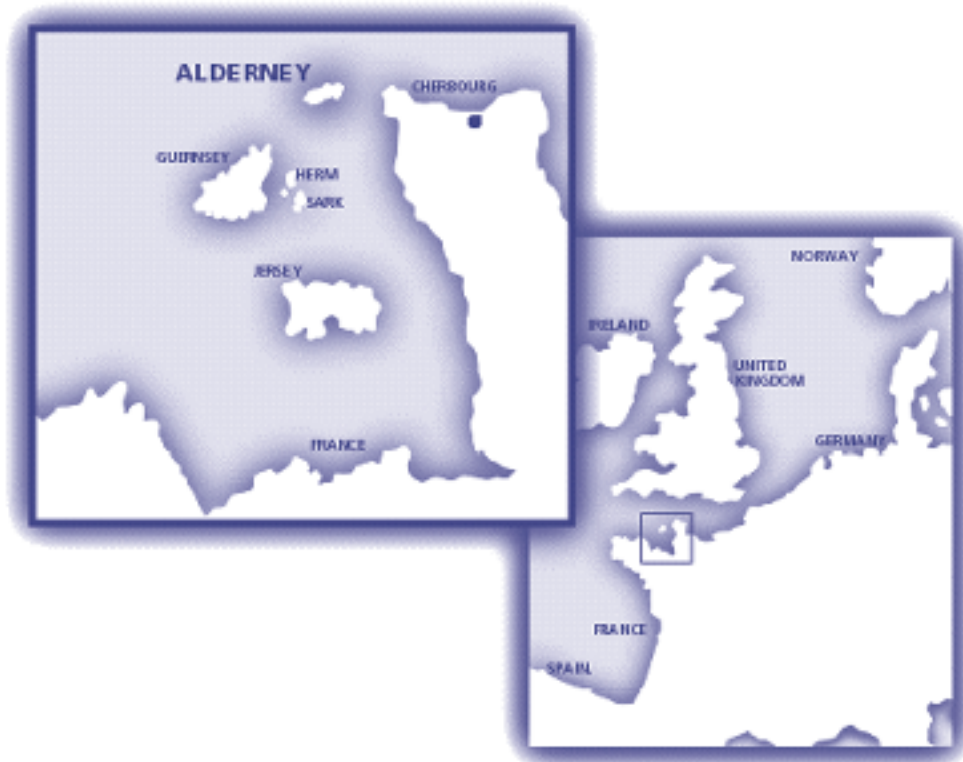
The surplus of Income over Expenditure for the year was £767,794, compared with £535,502 for the previous year, an increase of 43%. Income amounts to £1,291,566 compared with £940,536 in the previous year. Costs have increased by £118,738 (29%) to £523,772, the main items being an increase in staff costs and Commissioner's fees, following an independent review of Commissioner's fees towards the end of the previous year.

Assets and liabilities

Net assets at the year end stood at £1,345,925 compared with £578,131 at the end of the previous year. Assets included cash balances of £1,379,228 which have generated bank interest of £38,703, now a material item in the Income and Expenditure Account. Of these cash balances, £1,237,896 is held in the Guernsey Treasury Pool where the Commission obtains a better rate of return than from an independent deposit account.

Financial Statements

More detailed figures are set out in the Financial Statements of the Commission which are produced on pages 17 to 21.



Financial Statements for 2004

Statement of the Commissions responsibilities

The Alderney Gambling Control Commission ('the Commission') acknowledges that it is responsible for preparing financial statements for each financial year which give a true and fair view of the state of affairs of the Commission and of the profit or loss of the Commission for that period. In preparing those financial statements the Commission is required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Commission will continue in business.

The Commission is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Commission. The Commission also is responsible for safeguarding its assets and hence for taking reasonable steps for the prevention and the detection of fraud and other irregularities.

The following persons served on the Commission during the year under review:

- Mr. John Godfrey (Chairman);
- Mr. Raymond Birdseye;
- Mr. John Buggy; and
- Mr. John Clitheroe.

Independent auditors' report to the Commission

We have audited the financial statements on pages 17 to 21.

Respective responsibilities of commissioners and auditors

The Commissioners are responsible for preparing the Commission's report and, as described on page 15, the financial statements in accordance with UK accounting standards. Our responsibilities, as independent auditors, are established in Guernsey by Law, the UK Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the accounting policies set out in page 19. We also report to you if, in our opinion, the Commission has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the other information accompanying the financial statements and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with UK Auditing Standards issued by the Auditing Practices Board. An audit includes examination,

on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Commission in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Commission's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

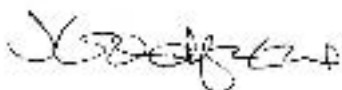
In our opinion the financial statements give a true and fair view of the state of the Commission's affairs as at 31 December 2004 and of its surplus for the year then ended and have been properly prepared in accordance with the accounting policies set out on page 19.

KPMG Channel Islands Limited
Guernsey
Chartered Accountants
11 April 2005

Balance Sheet as at 31st December 2004

	Note	2004 £	2003 £
Fixed assets			
Tangible assets	1	<u>9,249</u>	<u>11,109</u>
Current assets			
Debtors		8,100	5,911
Cash at bank and in hand	2	<u>1,379,228</u>	<u>603,141</u>
		1,387,328	609,052
Creditors: amounts falling due within one year	3	<u>(50,652)</u>	<u>(42,030)</u>
Net current assets		<u>1,336,676</u>	<u>567,022</u>
Total assets less current liabilities		<u><u>1,345,925</u></u>	<u><u>578,131</u></u>
Capital and reserves			
Revenue Account		<u><u>1,345,925</u></u>	<u><u>578,131</u></u>

The financial statements on pages 17 to 21 were approved by the Alderney Gambling Control Commission on 15 April 2004 and signed on its behalf by:



John Godfrey
Chairman

Revenue Account Year Ended 31st December 2004

	Note	2004 £	2003 £
Income			
Licence fees	4	1,200,650	840,650
Key personnel application fees	5	-	6,694
Investigation fees charged to applicants		43,626	65,152
Guernsey Gambling Control Commission	6	8,587	22,067
Bank interest		38,703	5,973
		<u>1,291,566</u>	<u>940,536</u>
Expenditure			
Staff costs		271,618	189,824
Commissioners' fees	7	81,000	64,050
Premises, furniture and equipment		25,802	25,537
Consultancy		29,969	24,258
Conferences and general travel		76,374	68,900
Postage, stationery and telephone		14,019	12,708
Audit and accountancy fees		3,603	2,570
Bank charges		523	376
Publications and subscriptions		6,074	5,151
Promotions		5,000	-
Sundry supplies and services		2,640	6,434
Depreciation	1	7,150	5,226
		<u>523,772</u>	<u>405,034</u>
Surplus		767,794	535,502
Surplus / (deficit) brought forward		578,131	42,629
Surplus carried forward		<u><u>1,345,925</u></u>	<u><u>578,131</u></u>

Accounting Policies Year Ended 31st December 2004

Basis of accounting

The financial statements have been prepared under the historical cost convention and in accordance with applicable UK accounting standards.

Depreciation

Depreciation is calculated using the straight line method, at the following rates:

Office furniture	- 25% per annum
Computers and related equipment	- 33% per annum

Licence fees

Licences granted by the Commission are valid for a period of three years, and a non-refundable licence fee is payable on issue of the licence and in advance of each anniversary of the issue of the licence. The licence fees are recognised in the Revenue account in the period in which they are received.

Cash flow statement

Under Financial Reporting Standard No 1, the entity is exempt from the requirements to prepare a cash flow statement on the ground of its size.

Notes to the Financial Statements Year Ended 31st December 2004

1. Tangible fixed assets	Computer equipment £	Office furniture £	Total £
Cost			
At 1 January 2004	9,942	10,387	20,329
Additions	4,463	1,199	5,662
Disposals		(940)	(940)
	<hr/>	<hr/>	<hr/>
At 31 December 2004	14,405	10,646	25,051
	<hr/>	<hr/>	<hr/>
Depreciation			
At 1 January 2004	5,137	4,083	9,220
Charge for year	4,407	2,744	7,150
Disposals		(568)	(568)
	<hr/>	<hr/>	<hr/>
At 31 December 2004	9,544	6,259	15,802
	<hr/>	<hr/>	<hr/>
Net book value			
At 31 December 2004	4,861	4,387	9,249
	<hr/>	<hr/>	<hr/>
At 31 December 2003	4,805	6,304	11,109
	<hr/>	<hr/>	<hr/>

2. Cash at bank and in hand	2004 £	2003 £
Cash at bank:		
Business reserve account	116,004	82,639
Applicant deposit account	25,209	9,791
Guernsey Treasury account	1,237,896	501,297
Current account	-	9,194
	<hr/>	<hr/>
Petty cash	119	220
	<hr/>	<hr/>
	1,379,228	603,141
	<hr/>	<hr/>

3. Creditors: amounts falling due within one year	2004	2003
	£	£
Refundable deposits	24,293	8,449
Accruals	21,949	33,581
Bank overdraft	4,410	–
	<u>50,652</u>	<u>42,030</u>

Refundable deposits cover the costs of investigating applicants and may be refundable in whole or in part.

4. Licence fees

During 2002 the States of Alderney and the Commission signed a Memorandum of Understanding under which licence fees are now paid to the Commission and are held by it for the benefit of the States of Alderney.

5. Key personnel application fees

During 2004 The Gambling (Interactive Gaming) (Alderney) Ordinance 2001, was amended such that a fee is no longer charged to key personnel applicants. Instead, a charge is made of the direct cost of investigation. A key personnel applicant must now forward a deposit of £1,000 upon application, which may be refunded in whole or in part.

6. GGCC Consultancy

The Commission charged consultancy fees to the Guernsey Gambling Control Commission (GGCC), in relation to the proposed casino on Guernsey. The fees include reimbursed direct expenses incurred by the Commission. Amounts owed to the Commission by the GGCC at the year end totalled £5,637 (2003 - £3,160).

7. Commissioners' fees

In accordance with the Gambling (Alderney) Law 1999, as amended, the States of Alderney meet the fees and expenses of the Commissioners, including the Chairman. Formally, in terms of the Memorandum of Understanding with the States of Alderney, the Commissioners' fees are administered by the AGCC.

8. Pension scheme and life assurance.

A defined contributions pension scheme, together with life assurance cover, is provided for employees. The scheme is administered by Anthony Le Blanc and Partners Limited in Alderney and was started in May 2002. The scheme requires employees to contribute 6% of gross salary to the scheme and the Commission contributes 7.5% of gross salary to the scheme on the employees' behalf. The total annual contribution of the Commission of £30,262 (2003 - £18,223) is included in staff costs. At the year end there were no prepaid or outstanding contributions (2003 – £nil).

Approach towards regulation

The main objectives of the Commission are to ensure that:

- all gaming and betting is conducted honestly and fairly;
- the funding, management and operation of online gambling on Alderney remains free from criminal influence; and
- gaming and betting activities are regulated and monitored so as to protect the interests of the public.

These objectives are reflected in the processes leading to approval for the conduct of gambling from Alderney, which are:

Licensing

Licensing is the first step. The main objective is to ensure that the applicant company is 'fit and proper'.

The owners, managers, system providers and sources of finance are all subjected to probity investigation. It is a rigorous process that involves the examination of financial records, including personal financial records, and the business history of the applicant company and its associates, in addition to the usual checks through police and financial intelligence records.

An applicant for a licence is required to take the following steps in connection with an application:

- incorporate a local company on whose behalf the application will be made;
- submit a formal application in the form approved by the Commission;
- lodge the investigation deposit with the Commission;
- supply a copy of the application to the Chief Officer of Police in Guernsey; and
- cause a notice, containing the particulars of the applicant and of their premises to be published in the Alderney Official Gazette, and displayed at both their premises and on the notice board outside the Court of Alderney.

If the Commission makes a finding of suitability, the applicant company and its key personnel will be awarded licences conditional on approval of both their operating and gambling systems and their internal controls. These further approvals are required before the licensee can commence business.

Technical compliance

Alderney was one of the first, and is still one of only a few, online gambling jurisdictions to have developed a set of technical standards against which the software system of the prospective operator is tested. This enables the operator to know what is required in advance and ensures that the tests are comprehensive and objective.

The tests may be carried out by any one of the testing authorities approved by the Commission. A Commission inspector is present during the negotiation of the contract for testing to ensure that the scope of the testing required to be undertaken is sufficient but no more than is necessary. Once the system has been approved and certified it can only be altered with the approval of the Commission.

In approving changes to the system, the Commission is conscious of the commercial realities of an online business and aims to deal with any changes quickly and pragmatically.

Internal controls

The Commission also provides detailed written guidelines for the submission of a suitable internal control system. The submission sets out the licensee's control procedures regarding such matters as:

- management structure and staffing;
- accounting systems;
- players accounts;
- the precise nature of the games offered; and
- computer controls.

Again, in approving the submission or any amendments to it, the Commission has regard to the commercial considerations of each online betting or gaming licensee.

Regulatory Framework

The relevant legislation is embodied in three Ordinances, namely the Interactive Gaming Ordinance, allowing for online casino gaming, the Electronic Betting Ordinance allowing for electronic betting centres and the Bookmakers Ordinance, allowing for the licensing of bookmakers in Alderney. However, as indicated in the report, the Interactive Gaming and Electronic Betting Ordinances will be integrated into a single eGambling Ordinance.

Both the Interactive Gaming and Electronic Betting Ordinances set out the legal framework for:

- applications for licences, including the application process, costs of investigation, grounds for refusal, requirements to be “fit and proper” to hold a licence or to be an associate of a licensee, annual fees and the period of validity of a licence;
- varying or adding conditions to licences, the modification or changes to the licensed premises and the return of the licence for the endorsement of changed conditions;
- suspension of licences, including the grounds for suspension, directions to rectify, cancellation of suspension, sanctions short of suspension and revocation of licences;
- nominees, including the requirements for a nominee, their functions and duties;
- key personnel, including the requirements to hold a key personnel licence, the application and investigation process, conditions of a key personnel licence, the lapsing and surrendering of key personnel licences; and
- compliance controls, which include matters such as the approval of gaming equipment, control systems, monitoring and investigation, financial accounts and audits.

In addition, the Interactive Gaming Ordinance provides for the issuing of a Certificate of Prior Approval to gaming system vendors, based anywhere in the world. This enables a distinction to be drawn between two categories of suppliers of interactive gaming equipment, namely:










- a supplier of gaming software who also offers a turnkey solution, where the casino owner is responsible for the marketing of the casino, but the day to day operation of the games is performed by the supplier on the owner’s behalf. The Ordinance permits only the holder of an interactive gaming licence to conduct interactive games. A system supplier in this category will therefore be required to obtain an interactive gaming licence; and
- a system vendor with no active part in the operation of the games. This type of supplier is considered to be a business associate of an interactive gaming licensee (or applicant for an interactive gaming licence) and, as such, is required to pass probity checks to ensure that the company is fit and proper to be associated with the operations conducted by the licensee. Such a supplier may apply for a Certificate of Prior Approval.

In addition to the legislative framework, the Commission has compiled extensive documentation to assist applicants, licensees and the public in understanding the regulatory approach and other requirements of the Commission. These comprise:



- Brief to interested parties for:
 - an electronic betting centre licence;
 - an interactive gaming licence; or
 - a certificate of prior approval.
- Application forms for:
 - an electronic betting centre licence;
 - an interactive gaming licence; or
 - a certificate of prior approval.
- Schedule of licence fees;
- General conditions of licence;
- Control system guidelines for:
 - an electronic betting centre licence; and
 - an interactive gaming licence.
- Procedures for objections to licensees; and
- Procedures for submitting player complaints.

These documents are all available on the Commission’s website, and can be accessed at www.gamblingcontrol.org

Licensees, Trading Names and Software Providers (at 31 December 2004)

Licensee Logo	Licensee	Gaming Site	Gaming Software Provider
	Ritz Interactive Ltd	www.theritzclublondon.com	
	Bonne Terre Alderney Ltd	www.skybetvegas.com	
	CryptoLogic Alderney Ltd		
	V I Limited Ltd (Interactive Gaming)		
	V I Limited Ltd (Electronic Betting)		
	Rank Interactivte Gaming Ltd	www.hardrockcasino.com	
	Harrah's Online Limited	www.luckyme.co.uk	

Licensees, Trading Names and Software Providers (at 31 December 2004)

Licensee Logo	Licensee	Gaming Site	Gaming Software Provider
	WagerWorks Alderney 2 Ltd	www.gameswxtra.co.uk	
	WagerWorks Alderney 4 Ltd	www.thepriceisrightgames.com	
	Blue Square Gaming (Alderney) Ltd	www.bluesquarecasino.com	
	WagerWorks 5 Alderney Ltd	www.virgingames.com	
	Cantor Casino (Alderney) Ltd		
	Paddy Power (Alderney) Ltd	www.paddypowwercasino.com	
	Samvo International Ltd (Electronic Betting)		

Compliance Checklist

Examples of areas typically reviewed in the course of compliance review are the following:

- Player registration;
- Credit extended to players;
- On-line player verification at commencement of a gaming session;
- Contact details for problem or compulsive gambling counselling;
- Advice regarding return to player and the rules of the games;
- Advice regarding session or account balances;
- Approvals for all significant system and game changes;
- Access controls to gaming equipment;
- Procedures followed during software maintenance and system changes;
- Verification of software changes;
- Resolution of player complaints and disputes;
- Recording of all game transaction details;
- Account reconciliation procedures;
- Management chart of organisation, including reporting lines and position descriptions; and
- Maintenance of statutory registers.

Quarterly Reports

Quarterly reports typically include the following items:

- Management accounts;
- A log of suspicious transactions;
- Particulars of any system malfunctions, including the reason and remedial action taken;
- Particulars of any attempted or actual security breach and the action taken;
- Particulars of large wins or jackpots paid;
- Particulars of significant customer complaints and their resolution;
- Changes in management staff; and
- Any other accounts or statements requested by the Commission.
- Unclaimed money reports;
- Particulars of top winners and losers;
- A list of voided transactions;
- Particulars of large funds transfers;
- Player balance summary report;
- Particulars of all manual adjustments to player accounts;
- Particulars of other significant events, such as:
 - RNG initialisation and re-seeding
 - Changes to gaming parameters;
 - Games activated or inactivated from system;
 - System shutdowns/restarts; and
 - Gaming application shutdowns/restarts.

In addition, the following system details are required:

- Current casino configuration;
- Return to player reports;
- Player exclusion reports;

The Commission's guidelines regarding change control requires that a list of all changes be submitted to the Commission on a quarterly basis.