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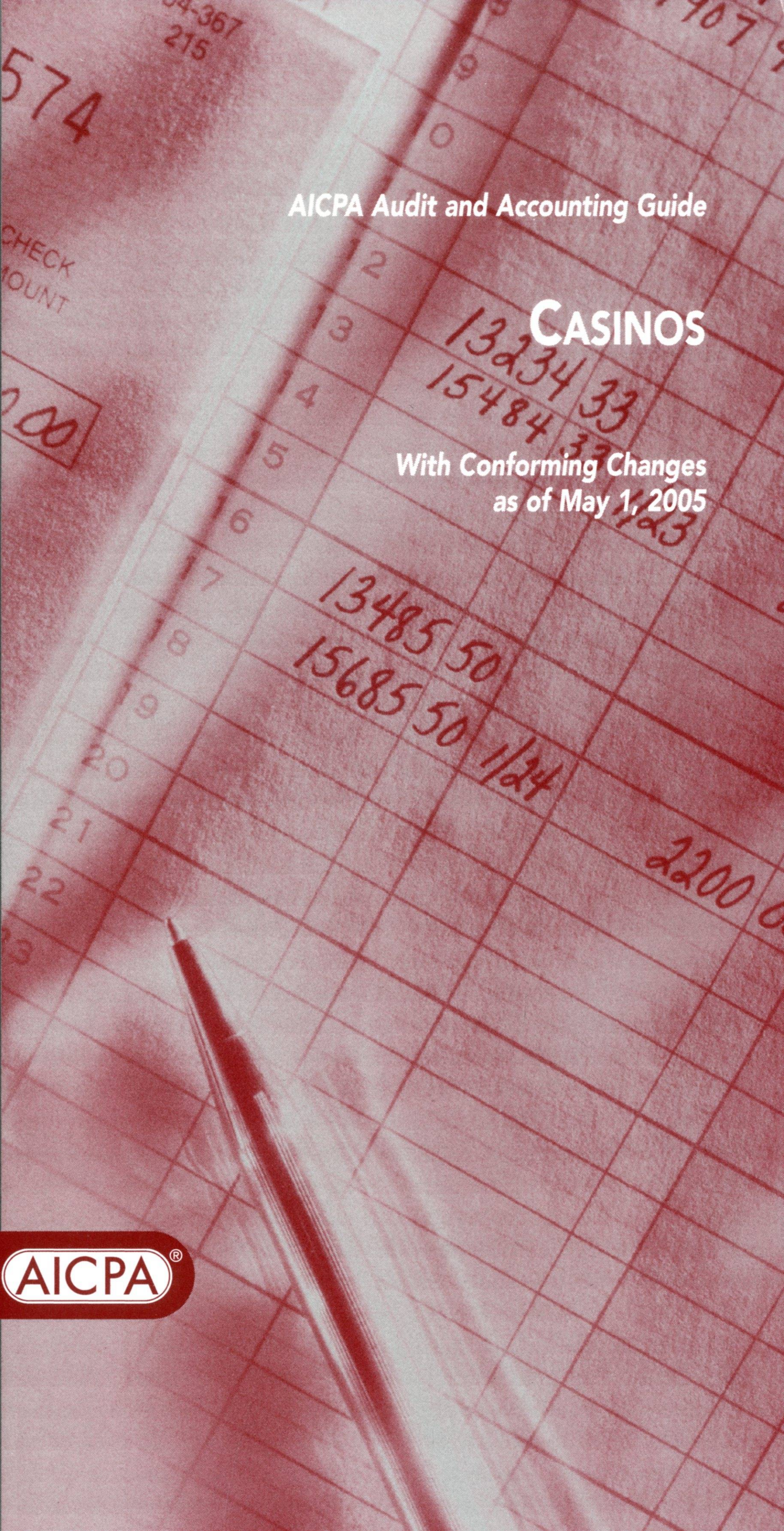
American Institute of Certified Public Accountants. Gaming Industry Special Committee



AICPA Audit and Accounting Guide

Casinos

With Conforming Changes
as of May 1, 2005

American Institute of Certified Public Accountants

AICPA®

AICPA Audit and Accounting Guide

CASINOS

With Conforming Changes as of May 1, 2005

This edition of the AICPA Audit and Accounting Guide *Casinos*, which was originally issued in 1984, has been modified by the AICPA staff to include certain changes necessary because of the issuance of authoritative pronouncements since the Guide was originally issued (see page iv). The changes made in the current year are identified in a schedule in Appendix H of the Guide. The changes do *not* include all those that might be considered necessary if the Guide were subjected to a comprehensive review and revision.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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Notice to Readers

This Audit and Accounting Guide presents recommendations of the AICPA Gaming Industry Special Committee on the application of generally accepted auditing standards to audits of financial statements of casinos. This Guide also presents the Committee's recommendations on and descriptions of financial accounting and reporting principles and practice for casinos. The AICPA Accounting Standards Executive Committee has found this Guide to be consistent with existing standards and principles covered by Rules 202 and 203 of the AICPA Code of Professional Conduct. AICPA members should be prepared to justify departures from the accounting guidance in this Guide.

Auditing guidance included in an AICPA Audit and Accounting Guide is an interpretive publication pursuant to Statement on Auditing Standards (SAS) No. 95, *Generally Accepted Auditing Standards*. Interpretive publications are recommendations on the application of SASs in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are issued under the authority of the Auditing Standards Board.

The auditor should identify interpretive publications applicable to his or her audit. If the auditor does not apply the auditing guidance included in an applicable interpretive publication, the auditor should be prepared to explain how he or she complied with the SAS provisions addressed by such auditing guidance.

Subject to the Securities and Exchange Commission (Commission) oversight, Section 103 of the Sarbanes-Oxley Act (Act) authorizes the Public Company Accounting Oversight Board (PCAOB) to establish auditing and related attestation, quality control, ethics, and independence standards to be used by registered public accounting firms in the preparation and issuance of audit reports as required by the Act or the rules of the Commission. Accordingly, public accounting firms registered with the PCAOB are required to adhere to all PCAOB standards in the audits of issuers, as defined by the Act and other entities when prescribed by the rules of the Commission.

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This Guide has been modified by the AICPA staff to include certain changes necessary due to the issuance of authoritative pronouncements since the Guide was originally issued. Relevant guidance contained in official pronouncements issued through May 1, 2005 has been considered in the development of this edition of the Guide. This includes relevant guidance issued up to and including the following:

- FASB Statement No. 153, *Exchange of Nonmonetary Assets—an amendment of APB Opinion No. 29*
- FASB Statement No. 123 (revised 2004), *Share-Based Payment*
- FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143*
- FASB Technical Bulletin 01-1, *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets*
- FASB Staff Positions issued through May 1, 2005
- FASB Emerging Issues Task Force (EITF) consensus positions adopted at meetings of the EITF held through April 2005
- Practice Bulletin No. 15, *Accounting by the Issuer of Surplus Notes*
- SAS No. 101, *Auditing Fair Value Measurements and Disclosures*
- SOP 04-2, *Accounting for Real Estate Time-Sharing Transactions*
- SSAE No. 12, *Amendment to Statement on Standards for Attestation Engagements No. 10*, Attestation Standards: Revision and Recodification
- PCAOB Auditing Standard No. 3, *Audit Documentation—And Amendment to Interim Auditing Standards*

Users of this Guide should consider pronouncements issued subsequent to those listed above to determine their effect on entities covered by this Guide.

The changes made for the current year are identified in a schedule in Appendix H of the Guide. The changes do not include all those that might be considered necessary if the Guide were subjected to a comprehensive review and revision.

Preface

This Audit and Accounting Guide has been prepared to assist preparers of financial statements in preparing financial statements in conformity with generally accepted accounting principles and to assist the independent auditor in auditing and reporting on financial statements of casinos by describing those conditions or procedures unique to the industry and by illustrating the form and content of casino financial statements and related disclosures.

Casino gambling is spreading to most regions of the U.S. Many casinos are "going public" or have been acquired by public companies. The expansion of corporate ownership of casinos and the increased activity of state regulatory authorities are bringing about many changes in the operation of casinos, including increased awareness of effective controls.

Although many casinos operate as hotel-casinos, and, accordingly, their financial statements reflect such combined operations, the discussion in this Guide pertains only to the casino operations. This Guide does not address forms of legalized gambling other than casinos. During the period that this Guide was developed, legalized casino gambling was conducted in Nevada and New Jersey, and the text was prepared based primarily on the operating practices in those states. Independent auditors should be alert for new or differing practices in other jurisdictions, including Puerto Rico and, when applicable, those outside the United States.

While generally accepted accounting principles and generally accepted auditing standards as they pertain to casinos are the same as those applicable to business entities in general, this Guide is directed to those matters considered particularly pertinent or unique to the casino industry.

Many terms in this Guide are unique to the casino industry. Those terms defined in Appendix G, "Glossary," are in italics the first time they appear in the Guide.

Effective Date

The provisions of this Guide shall be effective for audits of financial statements for periods ending on or after December 31, 1984.

Auditing Guidance Included in This Guide and References to AICPA and PCAOB Professional Standards

This Guide presents auditing guidance to help you implement auditing standards included in both AICPA professional standards ("GAAS") and in PCAOB professional standards. In referring to AICPA professional standards, this Guide cites the applicable sections of the AICPA *Professional Standards* publication. In referring to PCAOB standards, this Guide cites the applicable sections of the AICPA's publication titled *PCAOB Standards and Related Rules*. In those cases in which the auditing standards of the AICPA and those of the PCAOB are the same, this Guide cites the applicable section of the AICPA *Professional Standards* publication only.

Generally, references to Statements of Auditing Standards (SAS) have been removed from this Guide and only the AICPA professional standards references remain (e.g., AU). Appendix G of this Guide has been prepared to assist users in the transition.

Substantial Changes to the Audit Process Proposed

The AICPA's Auditing Standards Board (ASB) issued an exposure draft proposing eight new Statements on Auditing Standards (SASs) relating to the auditor's risk assessment process. The ASB believes that the requirements and guidance provided in the proposed SASs, if adopted, would result in a substantial change in audit practice and in more effective audits. The primary objective of the proposed SASs is to enhance auditors' application of the audit risk model in practice by requiring:

- A more in-depth understanding of the entity and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate them.
- A more rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.
- Improved linkage between the assessed risks and the nature, timing and extent of audit procedures performed in response to those risks.

The proposed SASs establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement in a financial statement audit, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks. Additionally, the proposed SASs establish standards and provide guidance on planning and supervision, the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion regarding the financial statements under audit. The proposed standards are expected to be issued as final standards at the end of 2005. Readers can access the proposed standards at AICPA Online (www.aicpa.org) and should be alert to future progress on this project.

Applicability of Requirements of the Sarbanes-Oxley Act of 2002, Related Securities and Exchange Commission Regulations, and Standards of the Public Company Accounting Oversight Board

Publicly-held companies and other "issuers" (see definition below) are subject to the provisions of the Sarbanes-Oxley Act of 2002 (Act) and related Securities and Exchange Commission (SEC) regulations implementing the Act. Their outside auditors are also subject to the provisions of the Act and to the rules and standards issued by the Public Company Accounting Oversight Board (PCAOB).

Presented below is a summary of certain key areas addressed by the Act, the SEC, and the PCAOB that are particularly relevant to the preparation and issuance of an issuer's financial statements and the preparation and issuance of an audit report on those financial statements. However, the provisions of the Act, the regulations of the SEC, and the rules and standards of the PCAOB are numerous and are not all addressed in this section or in this Guide. Issuers and their auditors should understand the provisions of the Act, the SEC regulations implementing the Act, and the rules and standards of the PCAOB, as applicable to their circumstances.

Definition of an Issuer

The Act states that the term "issuer" means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

Issuers, as defined by the Act, and other entities when prescribed by the rules of the SEC (collectively referred to in this Guide as "issuers" or "issuer") and their public accounting firms (who must be registered with the PCAOB) are subject to the provisions of the Act, implementing SEC regulations, and the rules and standards of the PCAOB, as appropriate.

Non-issuers are those entities not subject to the Act or the rules of the SEC.

Guidance for Issuers

Management Assessment of Internal Control

As directed by Section 404 of the Act, the SEC adopted final rules requiring companies subject to the reporting requirements of the Securities Exchange Act of 1934, other than registered investment companies and certain other entities, to include in their annual reports a report of management on the company's internal control over financial reporting. See the SEC Web site at www.sec.gov/rules/final/33-8238.htm for the full text of the regulation.

Companies that are "accelerated filers," as defined in Exchange Act Rule 12b-2, are required to comply with these rules for fiscal years ending on or after November 15, 2004. "Non-accelerated filers" and foreign private issuers filing their annual reports on Form 20-F or 40-F must begin to comply with the rules for the first fiscal year ending on or after July 15, 2006. See the SEC Web site at www.sec.gov/rules/final/33-8545.htm for further information.

The SEC rules clarify that management's assessment and report is limited to *internal control over financial reporting*. The SEC's definition of internal control encompasses the Committee of Sponsoring Organizations of the Treadway Commission (COSO) definition but the SEC does not mandate that the entity use COSO as its criteria for judging effectiveness.

The SEC rules also require management to evaluate any change in the entity's internal control that occurred during a fiscal quarter and that has materially affected, or is reasonably likely to materially affect, the entity's internal control over financial reporting.

Under the SEC rules, the company's annual 10-K must include:

1. Management's Annual Report on Internal Control Over Financial Reporting
2. Attestation Report of the Registered Public Accounting Firm
3. Changes in Internal Control Over Financial Reporting

The SEC rules also require management to evaluate any change in the entity's internal control that occurred during a fiscal quarter and that has materially affected, or is reasonably likely to materially affect, the entity's internal control over financial reporting.

Audit Committees and Corporate Governance

Section 301 of the Act establishes requirements related to the makeup and the responsibilities of an issuer's audit committee. Among those requirements—

- Each member of the audit committee must be a member of the board of directors of the issuer, and otherwise be independent.
- The audit committee of an issuer is directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer.
- The audit committee shall establish procedures for the "receipt, retention, and treatment of complaints" received by the issuer regarding accounting, internal controls, and auditing.

In April 2003, the SEC adopted a rule to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the audit committee requirements mandated by the Act.

Disclosure of Audit Committee Financial Expert and Code of Ethics

In January 2003, the SEC adopted amendments requiring issuers, other than registered investment companies, to include two new types of disclosures in their annual reports filed pursuant to the Securities Exchange Act of 1934. These amendments conform to Sections 406 and 407 of the Act and relate to disclosures concerning the audit committee's financial expert and code of ethics relating to the companies' officers. An amendment specifies that these disclosures are only required for annual reports.

Certification of Disclosure in an Issuer's Quarterly and Annual Reports

Section 302 of the Act requires the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) of each issuer to prepare a statement to accompany the audit report to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer."

In August 2002, the SEC adopted final rules for Certification of Disclosure in Companies' Quarterly and Annual Reports in response to Section 302 of the Act. CEOs and CFOs are now required to certify the financial and other information contained in quarterly and annual reports.

Improper Influence on Conduct of Audits

Section 303 of the Act makes it unlawful for any officer or director of an issuer to take any action to fraudulently influence, coerce, manipulate, or mislead any auditor engaged in the performance of an audit for the purpose of rendering the financial statements materially misleading. In April 2003, the SEC adopted rules implementing these provisions of the Act.

Disclosures in Periodic Reports

Section 401(a) of the Act requires that each financial report of an issuer that is required to be prepared in accordance with generally accepted accounting principles (GAAP) shall "reflect all material correcting adjustments . . . that have been identified by a registered accounting firm . . . ." In addition, "each annual and quarterly financial report . . . shall disclose all material off-balance sheet transactions" and "other relationships" with "unconsolidated entities" that may have a material current or future effect on the financial condition of the issuer.

In January 2003, the SEC adopted rules that require disclosure of material off-balance sheet transactions, arrangements, obligations, and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses. The rules require an issuer to provide an explanation of its off-balance sheet arrangements in a separately captioned subsection of the Management's Discussion and Analysis section of an issuer's disclosure documents.

Guidance for Auditors

The Act mandates a number of requirements concerning auditors of issuers, including mandatory registration with the PCAOB, the setting of auditing standards, inspections, investigations, disciplinary proceedings, prohibited activities, partner rotation, and reports to audit committees, among others. Auditors of issuers should familiarize themselves with applicable provisions of the Act and the standards of the PCAOB. The PCAOB continues to establish rules and standards implementing provisions of the Act concerning the auditors of issuers.

Applicability of Generally Accepted Auditing Standards and Public Company Accounting Oversight Board Standards

The Act authorizes the PCAOB to establish auditing and related attestation, quality control, ethics, and independence standards to be used by registered public accounting firms in the preparation and issuance of audit reports for entities subject to the Act or the rules of the SEC. Accordingly, public accounting firms registered with the PCAOB are required to adhere to all PCAOB standards in the audits of "issuers," as defined by the Act, and other entities when prescribed by the rules of the SEC.

For those entities not subject to the Act or the rules of the SEC, the preparation and issuance of audit reports remain governed by GAAS as issued by the ASB.

Major Existing Differences Between GAAS and PCAOB Standards

Major differences between GAAS and PCAOB standards are described in both Part I of volume one of the AICPA *Professional Standards* and in Part I of the AICPA publication titled, *PCAOB Standards and Related Rules*.

Auditor Reports to Audit Committees

Section 204 of the Act requires the accounting firm to report to the issuer's audit committee all "critical accounting policies and practices to be used. . .all alternative treatments of financial information within [GAAP] that have been discussed with management. . .ramifications of the use of such alternative disclosures and treatments, and the treatment preferred" by the firm.

Other Requirements

The Act contains requirements in a number of other important areas, and the SEC has issued implementing regulations in certain of those areas as well. For example,

- The Act prohibits auditors from performing certain non-audit or non-attest services. The SEC adopted amendments to its existing requirements regarding auditor independence to enhance the independence of accountants that audit and review financial statements and prepare attestation reports filed with the SEC. This rule conforms the SEC's regulations to Section 208(a) of the Act and, importantly, addresses the performance of non-audit services.

- The Act requires the lead audit or coordinating partner and the reviewing partner to rotate off of the audit every 5 years. (See SEC Releases 33-8183 and 33-8183A for SEC implementing rules.)
- The Act directs the PCAOB to require a second partner review and approval of audit reports (concurring review).
- The Act states that an accounting firm will not be able to provide audit services to an issuer if one of that issuer's top officials (CEO, Controller, CFO, Chief Accounting Officer, etc.) was employed by the firm and worked on the issuer's audit during the previous year.

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Chapter 1

Description of the Industry

History

1.01 Gambling has existed in every society, from the most primitive to the most complex. Gambling as we know it today has its roots in sixteenth-century Europe, when many games of chance that were forerunners of games now played in casinos throughout the world were developed. English colonists brought gambling to the New World in the seventeenth century. Gambling was severely restricted in Puritan New England; however, in New York and the southern colonies attitudes toward gambling were more lenient.

1.02 The modern era began in 1931 in Nevada, when the so-called wide-open gambling bill was passed. The passage of the bill was precipitated by (*a*) dissatisfaction with widespread illegal gambling, (*b*) the influence of the mining camp heritage, and (*c*) hopes for general enhancement of business within the state, which was suffering severely during the Depression.

1.03 Most of the nation felt that Nevada's experiment was doomed to failure, and, in fact, growth was slow during the initial ten years. The first major breakthrough occurred in 1937 with the opening of Harolds Club in Reno.

1.04 A turning point in Nevada's gaming history came in late 1946, when the Flamingo Hotel opened outside the Las Vegas city limits. The Flamingo's financial success prompted the development of several new hotel-casinos. Initially the casinos in Reno and Las Vegas catered mostly to local residents. However, with the introduction of the larger casinos, gambling became big business.

1.05 In 1950 a Senate committee conducted a study of Nevada casinos. As a result of its report, Nevada and the federal government expanded their control efforts. In 1959 the Nevada Gaming Commission was created as the state's authority in licensing and disciplinary matters, and the Gaming Control Board was established as the active operating regulatory authority over the daily activities of casinos.

1.06 Starting in the 1960s large corporations, some publicly held, became owners and operators of gambling properties.

1.07 In 1976 New Jersey voters passed a referendum allowing casino gambling in Atlantic City. It was hoped that casino gambling would contribute to the redevelopment of Atlantic City.

1.08 Most states have at least one form of legalized gambling. These include on-track and off-track betting on horse racing, on-track betting on dog racing, state lotteries, and jai alai. Casino gambling is legal in many areas of the world. Some of the casinos in other parts of the world are owned by publicly held companies based in the United States. In addition, legalized gaming throughout the United States has taken on the additional forms of Riverboat Gaming and Native American Gaming. With the expanded use of the Internet for conducting business transactions, Internet gaming companies have been formed in various parts of the world to provide on-line gaming and sports betting over the Internet. The legality of such forms of gaming continues to be debated and challenged throughout the world. However, on-line gaming over the internet is not legal in the United States and most significant gaming corporations have avoided such business opportunities pending the resolution of legal questions.

1.09 With the proliferation of gaming throughout the United States and the world, gaming facilities, in certain instances, have become large scale, destination resorts. Companies have invested significant amounts of capital in the physical plants of these facilities and derive a large portion of their revenues from ancillary sources including hotel, food and beverage and retail operations.

Regulation and Oversight

1.10 The ownership and operation of gaming facilities in the United States are subject to a number of laws, regulations, and ordinances concerning the responsibility, financial stability, and character of casino operators and persons financially interested or involved in casino operations.

1.11 Casinos are licensed by state or other local gaming authorities. The licenses are not transferable and must be renewed periodically. The licensing authorities have broad discretion in granting and renewing licenses.

1.12 Officers, directors, and certain key employees of a casino must be licensed by the gaming authorities, and employees associated with gaming must obtain licenses or work permits. The gaming authorities have the power to require the casino to (*a*) suspend or dismiss officers, directors, or other key employees or (*b*) sever relationships with other persons who refuse to file appropriate applications or whom the authorities find unsuitable to act in such capacities. Certain jurisdictions require all employees of the casino and companies that service the casino industry to be licensed.

1.13 If it is determined that gaming laws have been violated, a casino's gaming license can be limited, conditioned, suspended, or revoked, and the casino and persons involved may be subject to fines at the discretion of the applicable licensing authorities.

1.14 No person may acquire control of a casino (whether by ownership of securities, agreement, or otherwise) without the prior approval of the gaming authorities. The authorities may require controlling stockholders, officers, directors, and other persons having a substantial relationship or involvement with the casino to be found suitable for that relationship or involvement or to be licensed. The gaming authorities have the power to investigate any principal security holder.

1.15 To be licensed, the casinos may be required to give up certain management rights and are subject to requirements that do not apply to business entities in general. For example, some jurisdictions legislate detailed provisions concerning (*a*) employment practices of casino operators, contractors for casino facilities, and others; (*b*) security standards, management control activities, accounting and cash control methods, and reports to gaming authorities; (*c*) advertising, standards for entertainment, and distribution of alcoholic beverages; and (*d*) the purchase of gaming equipment.

1.16 For the operating methods that the casinos will use, some jurisdictions prescribe (*a*) the rules of the games, including minimum and maximum wagers and the manner of selling and redeeming chips and (*b*) the manner of granting credit, the duration of credit, and the enforceability of gaming debts.

1.17 Casino operators are generally required to file with regulatory agencies reports describing, in narrative and diagrammatic form, detailed operating procedures for gaming and gaming-related activities. An accounting system and internal control[1] must be established before a casino's operations begin. The systems and any significant revisions to them may be required to be evaluated and reported on by an independent auditor and are subject to review by the regulatory agencies.

1.18 Casinos are generally charged a fee or tax, based on a percent of gross gaming revenue, by the state in which they operate. In some jurisdictions the establishment is granted a gaming license only after it remits a monthly fee that is collected three months in advance. A jurisdiction may also require a casino to pay a deposit to ensure that the locality receives the tax revenue even if the casino ceases to operate.

1.19 In addition to the gross revenue fee or tax, certain jurisdictions also impose license fees on table games and/or coin-operated devices. County and city license fees are also common. The license fees are generally prepaid.

1.20 A wagering tax is levied by the federal government on *race and sports book* operators. This tax is based on a percent of the amount wagered by customers. The tax may be passed on to the customer by either increasing the amount the customer pays for a bet or deducting the amount from the customer's winnings. In addition, each race and sports book writer must pay an annual license fee.

1.21 In addition to the aforementioned fees and taxes, the operating costs of casino regulatory and investigatory agencies may be passed on to casinos in the form of additional fees.

1.22 Publicly held casinos are generally subject to requirements of federal securities laws, including the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the Exchange Act). Casinos whose securities are registered under the Exchange Act must comply with its reporting requirements through periodic filings with the SEC.

1.23 To deter and prevent criminal activity, especially *money laundering*, regulations, promulgated under the authority of the Bank Secrecy Act of 1970 and the USA-Patriot Act of 2001, were enacted. On September 26, 2002, the U.S. Department of the Treasury issued a final rule amending the Bank Secrecy Act requiring that casinos report suspicious transactions to the Department of the Treasury.

Brief Descriptions of the Games

1.24 The jurisdiction in which the casino is located determines the types of games of chance that the casino may operate. A brief description of the games most likely to be found in a casino follows. More detailed descriptions of some of these games are included in Appendix C, "Rules of the Games."

Table Games

1.25 As would be expected, table games are simply those that are played at a table and involve one or more players usually wagering against the casino

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[1] In some jurisdictions this is referred to as a *system of accounting and internal control*.

bankroll. The table may include a *layout*—a diagram, usually on felt, with spaces for the bets to be placed. The house is represented by *dealers*, which is a general term that may include *stickpersons, boxpersons,* and *croupiers*. The most common table games are—

- *Craps*, a game in which two dice are thrown and various bets are accepted on the outcome.
- *Blackjack,* or *Twenty-One*, a card game in which the object is to draw cards whose total is higher than the dealer's total without going over 21.
- *Roulette*, a game in which a ball is spun on a rotating wheel and drops into a numbered slot on the wheel. Bets are placed on which slot the ball will come to rest in.
- *Wheel of Fortune,* or *Big Six*, a game in which players bet on which number a large spinning wheel will stop at.
- *Baccarat*, a card game in which two hands, a player's hand and a banker's hand, are dealt. Wagers are made on which hand will be higher without exceeding 9.

Card Games

1.26 Card games such as *poker* and *panguingui (pan)* differ from table games in that the customers wager against each other rather than against the house. The revenue derived by the casino is merely a percentage *rake-off* or a *time buy-in*—a commission charged by the house for the privilege of playing in the establishment.

Slots and Other Coin-Operated Gaming Devices

1.27 Slots and other *coin-operated gaming devices* are machines in which the player generally deposits one or more coins for a chance to win a jackpot or other *payoff.* Payoffs may be based on the alignment of like symbols appearing on three or more narrow cylindrical drums, called reels, but there are many variations. These devices may also be machines that simulate other games, such as poker or blackjack, on a video screen. In addition, gaming manufacturers have offered multi-linked progressive systems to casinos. These systems provide the casino operator with the ability to provide significantly larger jackpot offerings in the casino and at the same time reduce the casino's risk for funding the jackpot since the administrator of the multi-linked progressive system is responsible for paying such jackpots from funds accumulated in a trust. The trust is established for the purpose of collecting from each participating casino their contractual portions of the drop from such machines and maintaining the trust sufficient to satisfy the previously awarded and current accrued progressive obligations. Typically, the progressive amount increases as a function of each coin played in any machine linked to the system.

Keno

1.28 A keno ticket has the numbers 1 through 80 on it. These numbers correspond to eighty numbered Ping-Pong-like balls contained in a special holding unit. Generally, twenty balls are then drawn randomly, and winning wagers are determined by how many numbers on the customer's ticket match those drawn.

Bingo

1.29 A *bingo* ticket has five rows of five numbers each. As numbers are selected at random by the casino, the players cover any corresponding numbers on their cards. The first customer to cover a specified row or design is the winner.

Race and Sports Book

1.30 Race and sports book is an operation in which the player places a bet on the outcome of a horse race or other sporting event.

Overview of Transactions in the Casino and the Casino Cage

Overview of Table Game Transactions

1.31 A simple illustration of a transaction cycle in a casino operation starts with the *casino cage* containing a specified amount of cash and a specified amount of *chips*[2] (*the house bankroll*). For a gaming table to have chips with which to operate, the chips are transferred from the casino cage, and a *fill slip* is prepared to record the transfer of the chips from the casino cage to the gaming table. A copy of the fill slip is deposited in the locked *drop box* attached to the gaming table. A player at a gaming table will generally be playing with chips acquired either in exchange for cash or on credit. If he is playing for cash, the cash is immediately placed in the drop box.

1.32 If the customer is playing on credit, he signs a credit instrument, in exchange for which he receives chips. A portion of this instrument form is ordinarily deposited in the drop box. The remaining portion of the instrument is ultimately transferred to the casino cage, where a *credit slip* is issued to the table issuing the instrument, thus placing the credit instrument in the custody of the casino cage and establishing *accountability* in the cage. Upon completion of play, the customer may take whatever chips he has remaining to the casino cage and use them to repay the credit and exchange any remaining chips for cash. (In certain jurisdictions, the procedures may be different; for example, credit instruments may be repaid at the table.)

1.33 At the change of a shift or the closing of a table, the gaming table returns all its chips to the cage, and a *credit slip* is prepared to record the transfer of the chips from the gaming table to the casino cage. A copy of the credit slip is deposited in the locked drop box attached to the gaming table. When the contents of the drop box are counted, the amount of *win* or loss is determined by totaling the amount of cash, the credit instruments issued, and the credit received for chips returned to the cage and by deducting the *fills* received from the cage. This net figure reflects the table win or loss. In most cases, however, the gaming table does not return all its chips to the cage. Instead, it maintains a *table inventory* of chips (which may be recorded on *openers* and *closers*), and thus, the increase or decrease in the table inventory during a shift also enters into the determination of table win or loss.

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[2] Gaming tables often have *tokens* and *plaques* in addition to *chips*. For simplicity, the term chips as used in this Guide also includes tokens and plaques.

1.34 The following list summarizes the types of transactions at gaming tables that affect the inventory of chips:

- A transfer of chips from the casino cage to a gaming table (documented by a fill slip)
- A transfer of chips to the casino cage from a gaming table (documented by a credit slip)
- A transfer (sale) of chips to a customer from the table inventory in exchange for either currency or a credit instrument
- Gaming transactions which result in either an increase or decrease in the table inventory, depending on whether the casino wins or loses the bets placed

1.35 All the above transactions, except gaming transactions, are either recorded on a document (fill slip, credit slip, or credit instrument) or are exchanges (currency for chips).

1.36 *Win or loss* is the change in the casino's net assets as a result of gaming transactions. The win or loss can be determined for each table in each shift as shown in the following illustration:

Cash in the drop box		$6,000
Credit issued and outstanding		3,000
Total *drop*		9,000
Less: Beginning table inventory	$14,000	
Chip Transfers		
Fills	5,000	
Credits	(1,000)	
	18,000	
Ending table inventory	(11,000)	7,000
Win		2,000

1.37 The computation of the win or loss amounts, by table, for each shift, is made on the *master game report,* or *stiff sheet.* These results are summarized by game into shift totals and daily totals.

Overview of the Slot Machine Cycle

1.38 An operating cycle for the *slot machine* starts with the *hopper* of a machine being loaded with a predetermined amount of coins of the required denomination (hopper *load*), which may be segregated in the casino cage accountability. The initial or subsequent hopper loads, or *slot fills,* are obtained from a *slot booth,* the casino cage, or the vault, depending on the individual operation. A fill slip or other numerically controlled form of documentation is prepared to record the transfer of coins.

1.39 As the slot machine is played, the hopper fills up with coins inserted by the customers and the coins overflow into the *drop bucket.* Machine payoffs to the customers will decrease the hopper and will occasionally require a slot fill.

1.40 When a customer hits a jackpot other than those paid automatically by the machine, the jackpot is paid by the *change person* from his change bank, the slot booth cashier, or the casino cage, concurrent with the completion of a numerically controlled *jackpot payout slip.* The payout of jackpots over a specified amount, as determined by the casino management, requires supervisor approval.

1.41 The drop buckets, which are secured in cabinets beneath the machines, are periodically removed and the coins are collected. Each machine's coins are counted or weighed to determine the slot *drop,* which is then recorded. This procedure is called the *hard count.* Many slot machines are also now equipped with currency or bill acceptors. The bill acceptors are typically removed at or near the same time as the drop buckets and are counted by machine in a slot *soft count*.

1.42 In certain jurisdictions, slot machines no longer accept or payout in coins. They are equipped with *currency acceptors* as noted in paragraph 1.41 or with ticketing devices that accept and pay tickets to patrons rather than cash or coins. The *ticket acceptors* are also removed at or near the same time as the currency acceptors.

1.43 Normally the *meters* on the machines are read in conjunction with the collection of the drop buckets and currency acceptors. Meters may be read visually or electronically, depending on the system in operation. Machines have one or more meters, such as coins-in, handle pulls, drop, coins-out, jackpot, and progressive jackpot. From the meter information, actual *hold percentages* can be computed and compared to the expected or *theoretical hold* percentages for each machine. Recorded drop-meter readings can be compared to the actual drop.

1.44 Win or loss is normally computed by machine, by denomination, and in total. Slot machine win or loss is equal to the drop less the fills and less any hand-paid jackpots.

Overview of the Cage and General Ledger Control

1.45 At the end of each shift the casino cage prepares a reconciliation, or accountability, of cash and cash equivalents in its possession. These may be summarized on a daily basis. This report includes the casino's inventory of currency, coins, credit instruments, and gaming chips and is reconciled to either an imprest balance maintained by the cage or, as is more often the case, the accountability at the end of the preceding period.

1.46 The change in the inventory levels of cash and cash equivalents is, in part, a function of the gaming transactions. For example, the cash inventory is affected by (*a*) the cash collected from table drop boxes and slot machine drop buckets and transferred to the cage, (*b*) payments received for credit instruments, (*c*) funds transferred to or from bank accounts, and (*d*) payments to patrons as they exchange chips or tickets for cash. Funds in excess of the anticipated currency and coin requirements for the next day's activity or in excess of the imprest balance maintained by the cage are deposited in bank accounts. The total of the credit instruments under the cage's control fluctuates due to instruments received from gaming tables and payments received at the cage. The amount of chips in the cage accountability changes due to the chips in the customers' possession (*chip float*).

1.47 In addition to cage accountability over cash and cash equivalents in its possession, general ledger control is also maintained. The general ledger control accounts at the period's end should agree with the cage's daily summaries.

Chapter 2

Accounting and Financial Reporting

2.01 Most of the accounting and financial reporting practices of the gaming industry are essentially the same as those of other industries. However, some accounting and financial matters are peculiar to the gaming industry and are explained in this Guide.

Casino Revenue Recognition [1]

2.02 Casino revenue is reported on the accrual basis. Revenue recognized and reported by a casino is generally defined as the win from gaming activities, that is, the difference between gaming wins and losses, not the total amount wagered.

Promotional Allowances

2.03 Promotional allowances (*complimentaries,* or *comps*) represent goods and services, which would be accounted for as revenue if sold, that a casino gives to customers as an inducement to gamble at that establishment. Examples are rooms, food, beverages, entertainment, and parking. The cost of providing promotional allowances is included in costs and expenses.

2.04 The retail amount of promotional allowances is often disclosed in the financial statements. This disclosure, if made, is preferably made in the financial statement notes. However, the retail amount of promotional allowances may be included in gross revenues and offset by deducting it from gross revenues on the face of the income statement. The retail amount of promotional allowances should not be included in gross revenues and charged to operating expenses because that would overstate both revenues and expenses.

Accounts Receivable

2.05 Many casinos grant credit to their gaming customers. The credit instruments include *markers* or *IOUs,* postdated or *hold checks, counter checks,* and returned checks held for deposit or other settlement by the customer. Credit play is accounted for on the accrual basis, with revenues and receivables from customers being recorded. The related casino revenue taxes based on the receivables are also accrued. Entities that extend trade credit to customers are

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[1] EITF Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*, addresses the recognition, measurement, and income statement classification for consideration given by a vendor to a customer, including certain sales incentives and membership loyalty programs, such as prearranged discounts given to customers on the repayment of credit extended, slot club promotional programs, and other incentive based offerings. EITF Issue No. 03-10, *Application of Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers,* and EITF Issue No. 02-16, *Accounting by a Customer (including a Reseller) for Certain Consideration Received from a Vendor*, addresses how a reseller should account for cash consideration received from a vendor, and EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, address how a vendor should account for certain arrangements under which the vendor will perform multiple revenue-generating activities. EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, states that whether a company should recognize revenue based on (*a*) the gross amount billed to a customer because it has earned revenue from the sale of the goods or services or (*b*) the net amount retained (that is, the amount billed to the customer less the amount paid to a supplier) because it has earned a commission or fee is a matter of judgment that depends on the relevant facts and circumstances.

included in the scope of the Statement of Position (SOP) 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*. SOP 01-6 established recognition and measurement principles and presentation and disclosure principles for such receivables. In addition, the AICPA Audit and Accounting Guide *Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies* applies to banks, savings institutions, credit unions, finance companies, and other entities (including entities with trade receivables) and is consistent with the scope of SOP 01-6.

Preopening,[2] Licensing, and Major Entertainment Production Costs

2.06 Some or all costs related to licensing costs and costs of major entertainment productions are either charged to expense as incurred or deferred and amortized. Preopening costs should be charged to expense as incurred. Licensing and major entertainment production costs should only be deferred and amortized where it is probable that they will benefit future periods. The costs of major entertainment productions are usually amortized over the period that management believes the productions will run. Other licensing costs should also be amortized over their periods of expected future benefit.

Income Taxes

2.07 Financial statement reporting for casinos differs from income tax reporting, resulting in deferred income taxes when (*a*) recognition of casino receivables is used for financial statements and the "when collected" method is used for income tax reporting, (*b*) costs are deferred for financial statements and are charged to expense for income tax reporting, and (*c*) progressive slot jackpots are accrued based on meter readings for financial statements and are charged against revenue when paid for income tax reporting.

Slot Club Promotional Systems

2.08 For marketing and customer tracking purposes, casinos typically offer slot club promotional programs wherein a patron registers with the casino and receives a magnetic card that is inserted into a card reader connected to the slot machine. When properly inserted into the card reader, the customer is able to accumulate "points" for each amount played on the slot machine. A customer usually may redeem such points for cash, gifts, food and beverage, hotel rooms or other goods and services. Cash received by the customer is typically but not necessarily put back into slot machines. The casino believes it is better able to track customer play and at the same time give incentives to its repeat and loyal customers.

Base Jackpots

2.09 *Base jackpots* are charged to revenue ratably over the period of play expected to precede payout; however, if immaterial, they are charged to revenue

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[2] SOP 98-5, *Reporting on the Costs of Start-Up Activities*, amends this Guide to require that preopening costs be charged to expense as incurred. SOP 98-5 is included in Appendix D of this Guide.

when established. Any portion of the base jackpot not charged to revenue when the jackpot is paid is charged to revenue at that time.

2.10 Normally, *progressive slot machines* contain base jackpots that increase at a progressive rate based on the number of coins played. (For example, each time a one-dollar coin is played, the amount of the jackpot is increased by five cents.) The accrual of the liability and the reduction of revenue as the amount of the jackpot increases results in recognition of liabilities and matching of costs and revenues.

Participating Slot Machines

2.11 In some operations, the casino pays a percentage of the win of participating slot machines to slot machine lessors. In those cases the win is usually recorded as revenue, and the participating fee is shown as an expense.

Accounting for Gaming Chips

2.12 Gaming chips are accounted for from the time the casino receives them even though the casino may not issue them immediately, but, instead, hold them in reserve. When a customer exchanges cash for gaming chips, the casino has a liability as long as those chips are not redeemed or won by the house. That liability is established by determining the difference between the total chips placed in service and the actual inventory of chips in custody or under the control of the casino. The chip liability is adjusted periodically to reflect an estimate of chips that will never be redeemed (for example, chips that have been lost, taken as souvenirs, and so on).

Customer Deposits

2.13 Customers sometimes deposit funds (*front money*) with a casino in advance, intending to draw on those funds later for gaming. Those deposits are recorded as a liability.

Race and Sports Book Operations

2.14 Some casinos accept wagers on the outcome of horse races and professional or amateur sporting events. The amount received is recorded as a liability until the final outcome of the event when the payoffs, if any, can be determined.

Gaming Regulations and Licensing

2.15 Continuity of the company's casino operations is subject to the applicable regulatory agency's granting or continuing the company's license. FASB Statement No. 5, *Accounting for Contingencies,* requires disclosure if unusual circumstances that may jeopardize the casino's license exist.

Industry Segment Information

2.16 Casino operations may include hotels, restaurants, parking garages, entertainment venues, retail shopping, and other activities. They may also have operations in various geographic areas.

2.17 FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, established standards for the way that public business enterprises report information about operating segments in annual financial statements. It also establishes standards for related disclosures about products and services, geographic areas, and major customers.

2.18 The method used to determine what information is reported under FASB Statement No. 131 is referred to as the management approach. This approach is based upon the way management organizes the segments within the enterprise for making operating decisions and assessing performance. It focuses on financial information that an enterprise's decision makers use to make decisions about an enterprise's operating matters. The components that management establishes are called *operating segments*.

2.19 An operating segment is defined in FASB Statement No. 131 as a component of an enterprise:

a. that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise)

b. whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

c. for which discrete financial information is available

See paragraphs 10–15 of FASB Statement No. 131 for further guidance in identifying operating segments.

2.20 An enterprise should report separately information about each operating segment that (*a*) has been identified pursuant to paragraphs 10–15 of FASB Statement No. 131 or that results from aggregating two or more of those operating segments pursuant to paragraph 17 of FASB Statement No. 131 and (*b*) exceeds the quantitative thresholds in paragraph 18 of FASB Statement No. 131. In addition, paragraphs 19–24 of FASB Statement No. 131 specify other situations in which separate information about an operating segment should be reported.[3]

2.21 Operations of a non-public business enterprise with a casino property that also includes a hotel, restaurant, parking garage, and the like are generally considered as one industry segment. The operating revenues of each are generally separately determinable. However, because of the natural interdependence of such operations, an allocation of costs among them to determine relative contributions to income (operating profit) would be largely arbitrary and, therefore, not meaningful. However, non-public casino business enterprises operating in various legal jurisdictions may have geographic segments and should therefore report such information.

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[3] EITF Issue No. 04-10, *Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds*, addresses the issue of how an enterprise should evaluate the aggregation criteria in paragraph 17 of FASB Statement No. 131 when determining whether operating segments that do not meet the quantitative thresholds may be aggregated in accordance with paragraph 19 of FASB Statement No. 131.

Chapter 3

*Auditing Considerations**

General Considerations

3.01 This section is not intended to mandate auditing procedures to be applied in every audit of a casino. Nor is the discussion of management's responsibility for internal control intended to prescribe the types of controls to be implemented in all circumstances. The types of controls required and the audit procedures performed by the auditor will vary depending on the nature of the operations and the results of the auditor's consideration of the casino's internal control and assessment of the materiality of account balances and individual transactions in relation to the financial statements as a whole.

Audit Planning

3.02 As expressed in AU sec. 311, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standard: AICPA, *PCAOB Standards and Related Rules*, AU sec. 311), audit planning involves developing an overall strategy for the expected conduct and scope of the audit. The extensiveness of planning varies with the size and complexity of the entity and the auditor's knowledge of the entity's business.

3.03 The auditor should understand the unique aspects of the gaming industry and should be aware of potential problem areas that may exist in a company engaged in casino operations. For example, experience has shown that a greater possibility of fraud exists in operations where there are people handling large amounts of cash. Some planning matters identified in AU sec. 311 and the related considerations involved in an audit of a casino are described in this chapter.

3.04 The auditor should become familiar with regulations and reporting requirements of regulatory authorities, as well as the authorities' involvement in the casino's control environment, before fieldwork starts. For audits conducted in accordance with PCAOB standards,[†] auditors must also comply with additional requirements concerning the effectiveness of internal control over financial reporting.

3.05 The auditor should read recent communications with regulatory agencies. If there are any investigations being made by government enforcement agencies, the auditor should be aware of the stage of any such investigation and management's and counsel's expectations of the outcome. These matters should generally be described by management in its representation letter to the auditor. AU sec. 333, *Management Representations*, as amended (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 333), establishes a requirement that an auditor, performing an audit in accordance

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[*] Refer to the Preface of this Guide for important information about the applicability of the professional standards to audits of issuers and non-issuers (see definitions in the Preface). As applicable, this chapter contains dual referencing to both the AICPA and the PCAOB's professional standards.

[†] See the PCAOB Web site at www.pcaobus.org for information about the effective dates of these conforming amendments.

with generally accepted auditing standards, obtain written representations for all financial statements and periods covered by the auditor's report. The Statement also provides guidance concerning the representations to be obtained, along with an illustrative management representation letter. Management representations specific to casinos may include:

- Compliance with gaming related rules and regulations
- Communications from gaming regulatory authorities

3.06 Regulations require many casinos to have internal audit staff. In applying AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, the auditor should be aware that the work of internal auditors in this industry may differ from that in other industries (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 322). A significant portion of the internal auditor's work involves observation of casino activities, and, accordingly, the auditor should consider the difficulties associated with examining documentary evidence of the internal auditor's work.

3.07 As part of the planning process, the auditor should apply analytical procedures to financial statement captions, account balances, quarterly financial statements, although the extent and timing of the procedures will vary from entity to entity. The purpose of such procedures is to identify matters (for example, unusual trends or transactions) that may have financial statement and audit planning ramifications. The auditor should also consider applying analytical procedures to non financial data (AICPA, *Professional Standards*, vol. 1, AU sec. 329.08, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 329.08). For a detailed discussion regarding analytical procedures see Chapter 5 of this Guide.

Establishing an Understanding With the Client

3.08 AU sec. 310.05–.07, *Appointment of the Independent Auditor*, as amended (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 310.05–.07), requires the auditor to establish an understanding with the client that includes the objectives of the engagement, the responsibilities of management and the auditor, and any limitations of the engagement. The Statement requires the auditor to document the understanding with the client, preferably through a written communication with the client. The Statement, as amended, provides guidance to the auditor for situations in which the practitioner believes that an understanding with the client has not been established. AU sec. 310, as amended, also identifies specific matters that ordinarily would be addressed in the understanding with the client, and other contractual matters an auditor might wish to include in the understanding.

Audit Objectives

3.09 AU sec. 326, *Evidential Matter* (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 326), provides the independent auditor with guidance on the third standard of fieldwork, as follows:

> In obtaining evidential matter in support of financial statement assertions, the auditor develops specific audit objectives in the light of

those assertions. In developing the audit objectives of a particular engagement, the auditor should consider the specific circumstances of the entity, including the nature of its economic activity and the accounting practices unique to its industry.

3.10 Most of the independent auditor's work in forming an opinion on financial statements consists of obtaining and evaluating evidential matter regarding management's assertions in financial statements. Assertions are representations by management that are embodied in financial statement components. They can be either explicit or implicit. These assertions can be classified into the five following broad categories:

a. *Existence or occurrence.* Do assets or liabilities of the entity exist at a given date, and have recorded transactions occurred during the given period? For casinos, some key areas where existence is an important assertion include cash on hand and fixed assets.

b. *Completeness.* Are all transactions and account balances that should be presented in the financial statements included? For casinos, some key areas where completeness is an important assertion includes; liabilities related to taxes, payroll and related amounts, accruals for gaming related items, unearned revenue and outstanding chips.

c. *Rights and obligations.* Do all assets belong to the entity, and are all liabilities obligations of the entity at a given date?

d. *Valuation or allocation.* Have all asset, liability, revenue, and expense components been included in the financial statements at their appropriate amounts? For casinos, some key areas where valuation is an important assertion include bad debt reserves, self-insurance accruals and impairments of long-lived assets.

e. *Presentation and disclosure.* Are components of the financial statements properly classified, described, and disclosed? For casinos, some key areas where presentation and disclosure is an important assertion include revenue recognition, guarantees, debt, and joint ventures.

Related Party Transactions

3.11 Obtaining knowledge of a client's business should also include performing the procedures in AU sec. 334.04, *Related Parties* (AICPA, *Professional Standards*, vol. 1), to determine the existence of related-party relationships and transactions with such parties.

3.12 AU sec. 334 states that, in auditing related-party transactions that are identified during the course of the audit, the independent accountant should be aware that the substance of a particular transaction could be significantly different from its form and that financial statements should recognize the substance of particular transactions rather than merely their legal form. Except for routine transactions, it will generally not be possible to determine whether a particular transaction would have taken place if the parties had not been related, or assuming it would have taken place, what the terms and manner of settlement would have been. Accordingly, it is difficult to substantiate representations that a related-party transaction was consummated on terms equivalent to those that prevail in arm's-length transactions.

Audit Risk and Materiality

3.13 AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*, as amended (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 312), states that the independent auditor should consider audit risk and materiality when planning the audit and designing auditing procedures. It also contains general guidance for the consideration of materiality levels, including a requirement to document the nature and effect of misstatements aggregated by the auditor and his or her conclusion as to whether the aggregated misstatements cause the financial statements to be materially misstated. When performing an integrated audit of financial statements and internal control over financial reporting in accordance with PCAOB standards, refer to paragraphs 22–23 of PCAOB Auditing Standard No. 2 (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320.22–.23),[‡] regarding materiality considerations.

3.14 Inherent risk and control risk, the combined risk of material misstatement, differ from detection risk in that they exist independently of the audit of financial statements, whereas detection risk relates to the independent auditor's procedures and can be changed at his or her discretion. Detection risk should bear an inverse relationship to the risk of material misstatement. The less the risk of material misstatement the independent auditor believes exists, the greater the detection risk he or she can accept. Conversely, the greater the risk of material misstatement the independent auditor believes exists, the less the detection risk he or she can accept. The following is a discussion of many of the principal risk factors inherent in the casino environment:

- Technology and Obsolescence
- Competition
- Laws, Regulations, and Taxation
- Turnover of key personnel
- Economic Risk
- Labor Relations
- Adequacy of Skilled Personnel

Accounting Estimates

3.15 The use of accounting estimates is an integral part of the preparation of financial statements. Management is responsible for making the accounting estimates used in the financial statements. When auditing accounting estimates, the independent auditor's objective is to obtain sufficient evidence to provide reasonable assurance that all material accounting estimates have been developed, that the accounting estimates are reasonable in the circumstances, and that the accounting estimates are in accordance with applicable accounting principles. Guidance for addressing estimates is included in AU sec. 342, *Auditing Accounting Estimates* (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 342); the AICPA Practice Aid, *Auditing Estimates and Other Soft Information*; and SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*.

[‡] See the PCAOB Web site at www.pcaobus.org for information about the effective dates of PCAOB Auditing Standard No. 2.

3.16 When performing an integrated audit of financial statements and internal control over financial reporting in accordance with PCAOB standards, the work that the auditor performs as part of the audit of internal control over financial reporting should necessarily inform the auditor's decisions about the approach he or she takes to auditing an estimate because, as part of the audit of internal control over financial reporting, the auditor would be required to obtain an understanding of the process management used to develop the estimate and to test controls over all relevant assertions related to the estimate.

3.17 In the case of accounting estimates, the auditor should be cognizant of the following and design appropriate procedures to test each:

- Bad debt reserves for accounts receivable
- Estimate of liability for point loyalty programs
- Self-insured health benefits accruals
- Estimated useful lives of property, equipment and intangible assets
- Outstanding chip and token liability
- Construction in progress accruals
- Impairment of goodwill, intangible and other long-lived assets
- Derivative Instruments
- Tax contingencies and accruals
- Restructuring and related accruals
- Legal claims and accruals

Going Concern Considerations

3.18 As part of the audit, the independent auditor is responsible for evaluating whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited. The evidence necessary to make this evaluation will usually be obtained through the auditor's planned audit procedures including review of compliance with debt agreements, analytical procedures, review of subsequent events, and so on. If after considering the identified conditions and events in the aggregate, the auditor believes that there is substantial doubt about the ability of an entity to continue as a going concern for a reasonable period of time, he or she should consider management's plans to mitigate the current conditions and events, the effect on the financial statements and the related disclosures, and the effect on his or her audit report. AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1), provides additional guidance in this area. The amendment clarified the required language that the auditor should include in an explanatory paragraph that describes his or her substantial doubt about an entity's ability to continue as a going concern. AU sec. 339, *Audit Documentation* (see the separate "Audit Documentation" section of this chapter), amended AU sec. 341 to indicate, in a section titled "Documentation," the required documentation in connection with guidance provided in AU sec. 341.

3.19 When auditing a casino, events requiring going concern consideration by an independent auditor may relate to insufficient cash flow to cover operating expenses (including casino bank roll and cash deficiencies) or debt service requirements, significant regulatory compliance deficiencies resulting in fines or license revocation, material litigation or claims exposures resulting in seizure of assets, and debt covenant violations for which waivers or debt agreement modifications have not been received.

Audit Documentation

3.20 The auditor should prepare and maintain audit documentation, the form and content of which should be designed to meet the circumstances of the particular audit engagement. Audit documentation is the principal record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor in the engagement. The quantity, type, and content of audit documentation are matters of the auditor's professional judgment.

3.21 Audit documentation serves mainly to:

a. Provide the principal support for the auditor's report, including the representation regarding observance of the standards of fieldwork, which is implicit in the reference in the report to generally accepted auditing standards.[1]

b. Aid the auditor in the conduct and supervision of the audit.

3.22 Examples of audit documentation are audit programs,[2] analyses, memoranda, letters of confirmation and representation, abstracts or copies of entity documents,[3] and schedules or commentaries prepared or obtained by the auditor. Audit documentation may be in paper form, electronic form, or other media.

3.23 Audit documentation should be sufficient to (*a*) enable members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent, and results of auditing procedures performed, and the evidence obtained;[4] (*b*) indicate the engagement team member(s) who performed and reviewed the work; and (*c*) show that the accounting records agree or reconcile with the financial statements or other information being reported on.

3.24 In addition to the requirements discussed in paragraphs 3.21–3.23 above, AU sec. 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1), provides further requirements about the content, ownership and confidentiality of audit documentation. Moreover, Appendix A to AU sec. 339 lists the audit documentation requirements contained in other statements on auditing standards.

3.25 For audits conducted in accordance with PCAOB standards, PCAOB Auditing Standard No. 3, *Audit Documentation* (AICPA, *PCAOB Standards and*

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[1] However, there is no intention to imply that the auditor would be precluded from supporting his or her report by other means in addition to audit documentation.

[2] See AU sec. 311.05, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1), for guidance regarding preparation of audit programs.

[3] Audit documentation should include abstracts or copies of significant contracts or agreements that were examined to evaluate the accounting for significant transactions. Additionally, audit documentation of tests of operating effectiveness of controls and substantive tests of details that involve inspection of documents or confirmation should identify the items tested.

[4] A firm of independent auditors has a responsibility to adopt a system of quality control policies and procedures to provide the firm with reasonable assurance that its personnel comply with applicable professional standards, including generally accepted auditing standards, and the firm's standards of quality in conducting individual audit engagements. Review of audit documentation and discussions with engagement team members are among the procedures a firm performs when monitoring compliance with the quality control policies and procedures that it has established. (Also, see AU sec. 161, *The Relationship of Generally Accepted Auditing Standards to Quality Control Standards*, as amended [AICPA, *Professional Standards*, vol. 1].)

Related Rules, AU sec. 339), supersedes AU sec. 339. PCAOB Auditing Standard No. 3 (AICPA, *PCAOB Standards and Related Rules*, AU sec. 339), establishes general requirements for documentation the auditor should prepare and retain in connection with engagements conducted pursuant to PCAOB standards. Audit documentation is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. This standard provides specific audit document requirements, provides guidance on documentation of specific matters, and retention of and subsequent changes to audit documentation, See PCAOB Auditing Standard No. 3 for further guidance.

Consideration of Fraud in a Financial Statement Audit

3.26 AU sec. 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards,* vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 316), is the primary source of authoritative guidance about an auditor's responsibilities concerning the consideration of fraud in a financial statement audit. AU sec. 316 provides guidance to auditors in fulfilling their responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud as stated in AU sec. 110.02, *Responsibilities and Functions of the Independent Auditor* (AICPA, *Professional Standards*, vol. 1). When performing an integrated audit of financial statements and internal control over financial reporting in accordance with PCAOB standards, auditors are required to refer to paragraphs 24–26 of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320.24–.26), regarding fraud considerations, in addition to the fraud considerations set forth in AU sec. 316. ‡

3.27 There are two types of misstatements relevant to the auditor's consideration of fraud in a financial statement audit:

- Misstatements arising from fraudulent financial reporting.
- Misstatements arising from misappropriation of assets.

3.28 Three conditions generally are present when fraud occurs. First, management or other employees have an *incentive* or are under *pressure,* which provides a reason to commit fraud. Second, circumstances exist—for example, the absence of controls, ineffective controls, or the ability of management to override controls—that provide an *opportunity* for a fraud to be perpetrated. Third, those involved are able to *rationalize* committing a fraudulent act.

The Importance of Exercising Professional Skepticism

3.29 Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the risk of material misstatement due to fraud. Professional skepticism is an attitude that includes

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‡ See footnote ‡ in paragraph 3.13.

a questioning mind and a critical assessment of audit evidence. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred.

Discussion Among Engagement Personnel Regarding the Risks of Material Misstatement Due to Fraud

3.30 Members of the audit team should discuss the potential for material misstatement due to fraud in accordance with the requirements of paragraphs .14–.18 of AU sec. 316. The discussion among the audit team members about the susceptibility of the entity's financial statements to material misstatement due to fraud should include a consideration of the known external and internal factors affecting the entity that might (*a*) create incentives/pressures for management and others to commit fraud, (*b*) provide the opportunity for fraud to be perpetrated, and (*c*) indicate a culture or environment that enables management to rationalize committing fraud. Communication among the audit team members about the risks of material misstatement due to fraud also should continue throughout the audit.

3.31 The following are potential fraud risk factors specific to or significant for casinos. This listing does not include all fraud factors, and does not list many fraud factors that might exist in any entity. They include incentives and pressures to commit fraud, opportunities that might allow fraud to occur and attitudes and rationalizations that might accommodate the existence of fraud.

Incentives/Pressures

- Financial stability pressures, which may arise from poor business levels in a particular market, economic slowdowns in the region (or economic conditions affecting the areas where customers reside) or from increased taxation.
- Expectations pressure, which would be most relevant for public companies where quarterly earnings expectations are important, or for companies subject to restrictive debt covenants.
- Management incentives, such as when management's compensation is highly dependent on operating results, either in the short term due to bonus arrangements based on operating profit, or longer term due to significant stock or stock option holdings. For entities with multiple casinos, this can be a risk at both the corporate and business unit level.
- One person dominates management operating and financing decision making process.
- Management places undue emphasis on meeting earnings projections and or industry targets.

Opportunities

- Judgmental reserves and accruals, including bad debts, tax contingencies, large quantities of cash, strong emphasis on casino internal control with a lack of emphasis given to ancillary lines of business, and health insurance accruals. These accounts require significant estimates and assumptions, and can be manipulated through non-recurring, period-end journal entries.

- Decentralized operations. Many entities operate multiple casinos in various locations. In many cases, significant operating authority is delegated to local management. In some cases, casinos have foreign operations as well. Lack of central control or proper monitoring procedures can increase the risk of fraud.
- Accounting for property and equipment, including capitalization vs. expense decisions, depreciable lives, and impairment accounting, is an area of potential manipulation which can be significant given the high dollar amounts of property and equipment at many casinos.

Attitudes/Rationalizations

- Issuance of credit and complimentaries with the possibility of employee kickbacks.
- High turnover of staff
- Large number of employees, or ghost employees
- Large number of vendors with fungible products

Obtaining the Information Needed to Identify the Risks of Material Misstatement Due to Fraud

3.32 AU sec. 311.06–.08, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1), provides guidance about how the auditor obtains knowledge about the entity's business and the industry in which it operates. In performing that work, information may come to the auditor's attention that should be considered in identifying risks of material misstatement due to fraud. As part of this work, the auditor should perform the following procedures to obtain information that is used (as described in paragraphs .35 through .42 of AU sec. 316) to identify the risks of material misstatement due to fraud:

a. Make inquiries of management and others within the entity to obtain their views about the risks of fraud and how they are addressed. (See paragraphs .20 through .27 of AU sec. 316.)

b. Consider any unusual or unexpected relationships that have been identified in performing analytical procedures in planning the audit. (See paragraphs .28 through .30 of AU sec. 316.)

c. Consider whether one or more fraud risk factors exist. (See paragraphs .31 through .33 of AU sec. 316, the Appendix to AU sec. 316 and paragraph 3.34 below.)

d. Consider other information that may be helpful in the identification of risks of material misstatement due to fraud. (See paragraph .34 of AU sec. 316.)

3.33 In planning the audit, the auditor also should perform analytical procedures relating to revenue with the objective of identifying unusual or unexpected relationships involving revenue accounts that may indicate a material misstatement due to fraudulent financial reporting. For example, in the casino industry, the following analytical procedures may be useful in identifying areas for further investigation:

- Unusually high revenue growth compared to market revenue growth
- Cash flow or operating margins which are flat or declining during periods of revenue growth

- Changes in the ratio of provision for doubtful accounts to markers issued, changes in bad debt allowance percentages, or changes in days sales outstanding
- Unusual table games or slots win percentages over a sustained period
- Unusually high operating growth margin
- Unusual marker collection rate percentages

For additional analytical procedures see Chapter 5 of this Guide.

Considering Fraud Risk Factors

3.34 As indicated in item 3.32*c* above, the auditor may identify events or conditions that indicate incentives/pressures to perpetrate fraud, opportunities to carry out the fraud, or attitudes/rationalizations to justify a fraudulent action. Such events or conditions are referred to as "fraud risk factors." Fraud risk factors do not necessarily indicate the existence of fraud; however, they often are present in circumstances where fraud exists.

3.35 AU sec. 316 provides fraud risk factor examples that have been written to apply to most enterprises. Remember that fraud risk factors are only one of several sources of information an auditor considers when identifying and assessing risk of material misstatement due to fraud.

Identifying Risks That May Result in a Material Misstatement Due to Fraud

3.36 In identifying risks of material misstatement due to fraud, it is helpful for the auditor to consider the information that has been gathered in accordance with the requirements of paragraphs .19 through .34 of AU sec. 316. The auditor's identification of fraud risks may be influenced by characteristics such as the size, complexity, and ownership attributes of the entity. In addition, the auditor should evaluate whether identified risks of material misstatement due to fraud can be related to specific financial-statement account balances or classes of transactions and related assertions, or whether they relate more pervasively to the financial statements as a whole. Certain accounts, classes of transactions, and assertions that have high inherent risk because they involve a high degree of management judgment and subjectivity also may present risks of material misstatement due to fraud because they are susceptible to manipulation by management.

A Presumption That Improper Revenue Recognition Is a Fraud Risk

3.37 Material misstatements due to fraudulent financial reporting often result from an overstatement of revenues (for example, through premature revenue recognition or recording fictitious revenues) or an understatement of revenues (for example, through improperly shifting revenues to a later period). Therefore, the auditor should ordinarily presume that there is a risk of material misstatement due to fraud relating to revenue recognition. (See paragraph .41 of AU sec. 316.) Some factors when considering material misstatements due to fraud in the area of revenue recognition for casinos are:

1. The nature of the way revenue is recorded in the casino industry
2. Almost all casino revenue is cash-based; and cash is inherently susceptible to misappropriation

3. Hotel, food, beverage and ancillary revenue typically consists of large numbers of individually small transactions
4. Recognition and classification of pre-arranged discounts on markers issued. These discounts must be recognized in the appropriate period, and the volume of discounts are typically high around the traditional New Year's period
5. Slot technology has made significant advances, causing the process used to record revenue to change. This increases the risk of manipulation, since those reviewing the results of transaction processing may not have extensive knowledge of new processes
6. Incentives provided to customers may be judgmental, and can affect reported revenue. Also the systems used to award customer incentives may be susceptible to manipulation given the increasing use of incentives and the relatively new technology.

A Consideration of the Risk of Management Override of Controls

3.38 Even if specific risks of material misstatement due to fraud are not identified by the auditor, there is a possibility that management override of controls could occur, and accordingly, the auditor should address that risk (see paragraph .57 of AU sec. 316) apart from any conclusions regarding the existence of more specifically identifiable risks. Specifically, the procedures described in paragraphs .58 through .67 of AU sec. 316 should be performed to further address the risk of management override of controls. These procedures include (1) examining journal entries and other adjustments for evidence of possible material misstatement due to fraud, (2) reviewing accounting estimates for biases that could result in material misstatement due to fraud, and (3) evaluating the business rationale for significant unusual transactions.

Key Estimates

3.39 Some key estimates for casinos involve:

- Bad debt reserves for accounts receivable
- Estimate of liability for point loyalty programs
- Self-insured health benefits accruals
- Estimated useful lives of property, equipment and intangible assets
- Outstanding chip and token liability
- Construction in progress
- Impairment of goodwill, intangible and other long-lived assets
- Derivative instruments
- Tax contingencies and accruals
- Restructuring and related accruals
- Legal claims and accruals

Assessing the Identified Risks After Taking Into Account an Evaluation of the Entity's Programs and Controls That Address the Risks

3.40 Auditors should comply with the requirements of paragraphs .43 through .45 of AU sec. 316 concerning an entity's programs and controls that address identified risks of material misstatement due to fraud. Some examples of programs and controls in the casino industry are:

- Controls over recording casino revenue, including required internal audits
- Capital budget and project approval requirements and monitoring over capital spending
- Multiple levels of review of financial information on a daily and monthly basis to identify unusual trends
- Regular review of the bad debt reserve along with controls over credit issuance and collection
- Disciplined closing procedures, including reconciliation of balance sheet accounts to supporting documentation
- Safeguarding of cash and other assets

3.41 Providing the controls are operating effectively, the auditor should consider whether such programs and controls mitigate the identified risks of material misstatement due to fraud or whether specific control deficiencies may exacerbate the risks. After the auditor has evaluated whether the entity's programs and controls have been suitably designed and placed in operation, the auditor should assess these risks taking into account that evaluation. This assessment should be considered when developing the auditor's response to the identified risks of material misstatement due to fraud.

Responding to the Results of the Assessment

3.42 Paragraphs .46 through .67 of AU sec. 316 provide requirements and guidance about an auditor's response to the results of the assessment of the risks of material misstatement due to fraud. The auditor responds to risks of material misstatement due to fraud in the following three ways:

a. A response that has an overall effect on how the audit is conducted—that is, a response involving more general considerations apart from the specific procedures otherwise planned. (See paragraph .50 of AU sec. 316.)

b. A response to identified risks involving the nature, timing, and extent of the auditing procedures to be performed. (See paragraphs .51 through .56 of AU sec. 316.)

c. A response involving the performance of certain procedures to further address the risk of material misstatement due to fraud involving management override of controls, given the unpredictable ways in which such override could occur. (See paragraphs .57 through .67 of AU sec. 316.)

Evaluating Audit Evidence

3.43 Paragraphs .68 through .78 of AU sec. 316 provide requirements and guidance for evaluating audit evidence. The auditor should evaluate whether analytical procedures that were performed as substantive tests or in the overall review stage of the audit indicate a previously unrecognized risk of material misstatement due to fraud. The auditor also should consider whether responses to inquiries throughout the audit about analytical relationships have been vague or implausible, or have produced evidence that is inconsistent with other evidential matter accumulated during the audit.

3.44 At or near the completion of fieldwork, the auditor should evaluate whether the accumulated results of auditing procedures and other observations affect the assessment of the risks of material misstatement due to fraud made earlier in the audit. As part of this evaluation, the auditor with final responsibility for the audit should ascertain that there has been appropriate communication with the other audit team members throughout the audit regarding information or conditions indicative of risks of material misstatement due to fraud.

Responding to Misstatements That May Be the Result of Fraud

3.45 When audit test results identify misstatements in the financial statements, the auditor should consider whether such misstatements may be indicative of fraud. See paragraphs .75 through .78 of AU sec. 316 for requirements and guidance about an auditor's response to misstatements that may be the result of fraud. If the auditor believes that misstatements are or may be the result of fraud, but the effect of the misstatements is not material to the financial statements, the auditor nevertheless should evaluate the implications, especially those dealing with the organizational position of the person(s) involved.

3.46 If the auditor believes that the misstatement is or may be the result of fraud, and either has determined that the effect could be material to the financial statements or has been unable to evaluate whether the effect is material, the auditor should:

a. Attempt to obtain additional evidential matter to determine whether material fraud has occurred or is likely to have occurred, and, if so, its effect on the financial statements and the auditor's report thereon.[5]

b. Consider the implications for other aspects of the audit. (See paragraph .76 of AU sec. 316.)

c. Discuss the matter and the approach for further investigation with an appropriate level of management that is at least one level above those involved, and with senior management and the audit committee.[6]

d. If appropriate, suggest that the client consult with legal counsel.

3.47 The auditor's consideration of the risks of material misstatement and the results of audit tests may indicate such a significant risk of material misstatement due to fraud that the auditor should consider withdrawing from the engagement and communicating the reasons for withdrawal to the audit committee or others with equivalent authority and responsibility. The auditor may wish to consult with legal counsel when considering withdrawal from an engagement.

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[5] See AU sec. 508 for guidance on auditors' reports issued in connection with audits of financial statements (AICPA, *Professional Standards*, vol. 1). For audits conducted in accordance with PCAOB standards (AICPA, *PCAOB Standards and Related Rules*, AU sec. 508), when performing an integrated audit of financial statements and internal control over financial reporting, the auditor may choose to issue a combined report or separate reports on the company's financial statements and on internal control over financial reporting. Refer to paragraphs 162–199 of PCAOB Auditing Standard No. 2 (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320.162–.199), for direction on reporting on internal control over financial reporting. In addition, see Appendix A, "Illustrative Reports on Internal Control Over Financial Reporting," of PCAOB Auditing Standard No. 2, which includes an illustrative combined audit report and examples of separate reports.

[6] If the auditor believes senior management may be involved, discussion of the matter directly with the audit committee may be appropriate.

Communicating About Possible Fraud to Management, the Audit Committee, and Others

3.48 Whenever the auditor has determined that there is evidence that fraud may exist, that matter should be brought to the attention of an appropriate level of management. See paragraphs .79 through .82 of AU sec. 316 for further requirements and guidance about communications with management, the audit committee, and others.

Documenting the Auditor's Consideration of Fraud

3.49 Paragraph .83 of AU sec. 316 requires certain items and events to be documented by the auditor. Auditors should comply with those requirements.

Practical Guidance

3.50 The AICPA Practice Aid, *Fraud Detection in a GAAS Audit*, revised edition, provides a wealth of information and help on complying with the provisions of AU sec. 316. This Practice Aid is an Other Auditing Publication as defined in AU sec. 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Other Auditing Publications have no authoritative status; however, they may help the auditor understand and apply SASs.

Illegal Acts

3.51 AU sec. 317, *Illegal Acts by Clients*, provides guidance on the nature and extent of the considerations the independent auditor should give to the possibility of illegal acts by clients. Illegal acts may vary considerably in their relation to the financial statements. The auditor considers laws and regulations that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts. Some examples are as follows:

- Compliance with gaming rules, regulatory bodies, governments, and immigration rules,
- Political dealings in terms of trying to enter or open new jurisdictions
- Political dealings in terms of trying to enter or open new jurisdictions
- Negotiating and maintaining relationships with unions
- Preferential treatment from or to vendors and in some jurisdictions doing business with unlicensed entities
- Compliance with the Bank Secrecy Act of 1970 and the USA-Patriot Act of 2001.

3.52 AU sec. 317 provides that the independent auditor's responsibility to detect and report misstatements resulting from illegal acts that have a direct and material effect on the determination of financial statement amounts is the same as that for errors and fraud as described in AU sec. 316.

Special Considerations

Timing

3.53 The nature, timing, and extent of the audit procedures to be performed and the resulting reports to be issued are determined by the independent auditor based on a number of factors. The auditor must also consider regulatory restrictions and requirements on the timing of the audit. The independent auditor may determine that a significant amount of the audit can be performed at an interim date. In such cases, AU sec. 313, *Substantive Tests Prior to the Balance Sheet Date*, includes factors to be considered in the timing of audit procedures. AU sec. 313.08 provides guidance on extending audit conclusions to the balance-sheet date and states "substantive tests should be designed to cover the remaining period in such a way that the assurance from those tests and the substantive tests applied to the details of the balance as of an interim date, and any audit assurance provided from the assessed level of control risks, achieve the audit objectives at the balance-sheet date." (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 313.)

3.54 When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 98–103 of PCAOB Auditing Standard No. 2 (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320.98–.103), regarding timing of test of controls.

3.55 Tests of controls over accountability and casino revenue should normally be performed periodically during the year. Generally, these audit procedures include observations of compliance with controls, such as those relating to the casino cage, count rooms, *pit*, and other casino operating procedures. Specifically, these audit procedures normally include the observation of (*a*) the collection of drop boxes and drop buckets and slot machine bill acceptors; (*b*) cage and count room procedures; (*c*) fill, credit, and credit instrument procedures; and (*d*) other casino procedures.

3.56 The observation of the cash count, the principal substantive test regarding existence of cash, is usually done as of the balance sheet date, but the count may be performed at an earlier or later time in some instances. If the observation is done at an interim date, the auditor should perform substantive tests that are sufficient to provide a reasonable basis to extend the observation-based conclusions to the balance sheet date. The absence of controls that provide assurance about the completeness of the recording of transactions and the physical movement of assets may impair the effectiveness of those substantive tests. (See AU sec. 310, *Appointment of the Independent Auditor*, as amended.)

3.57 In normal circumstances, when an auditor is appointed to perform an audit close to a company's year-end, although the timing of the observation of inventory is critical, audit work that might normally have been performed on an interim basis may be shifted to year-end. However, when auditing the financial statements of a casino, retroactive satisfaction about compliance with certain controls, particularly those relating to casino revenues, usually cannot be obtained. These controls are those that do not produce a trail of documentary evidence or those that are particularly susceptible to noncompliance and thus result in errors or fraud. If the auditor is not able to carry out observational tests of compliance during a substantial part of the period covered by his audit, the scope of his audit may be limited and his opinion may be appropriately qualified or disclaimed.

Accounts Receivable

3.58 The audit procedures for casino receivables require special care by the auditor and cooperation from the client so that customers are not alienated and the scope of the audit is not restricted. Since the response to positive confirmation of transactions and account balances might be low, the auditor should be prepared to use alternative methods of determining the existence and proper valuation of casino receivables. (Additional information regarding accounts receivable may be found in Chapter 7 of this Guide.)

3.59 In some jurisdictions regulatory agency auditors also confirm casino receivables, and therefore consideration may be given to coordinating confirmation requests if possible or practical.

Staffing

3.60 Ideally, the selection of the audit staff is based on such criteria as experience in the industry, knowledge of casino operations, and, if applicable, related hotel and food service knowledge. Training programs and briefing sessions should be considered.

Branch Offices

3.61 The client may have out-of-town reservation offices and agents that hold cash and original casino receivable documents. The auditor should consider whether such locations need to be visited to perform tests of controls and other substantive procedures relating to cash and for inspection of receivable documents.

Other

3.62 The auditor should be aware of the casino's promotional programs, such as coupon redemptions, *junkets*, promotional allowances, and other giveaway programs. The nature, timing, and extent of audit procedures regarding them will depend on the type of programs in use and their significance.

Chapter 4

Consideration of Internal Control*

4.01 Gaming operations are subject to a greater-than-normal risk of loss as a result of employee or customer dishonesty because (*a*) it is not practical to record all individual table game transactions, (*b*) cash receipts or equivalents are not recorded until they are removed from the drop boxes and counted, and (*c*) the revenues produced are not from the sale of products or services that are readily measurable. Management is responsible for reducing such risks to the extent practicable without significant impediment to play and within the limits of reasonable cost by establishing and maintaining internal control, including control activities for the supervision of employees. (Appendix A illustrates management control objectives of certain casino operations.)

4.02 The broad area of casino controls covers controls over authorization, accountability, and safekeeping. These controls take the form of paper safeguards, physical safekeeping, and human safeguards. Transactions are normally subject to being witnessed, recounted, validated, analyzed, initialed, or a combination of these.

4.03 Paper controls include forms and other documentation that are originated, checked, and followed through the process or system with appropriate approval steps or check points along the way. Financial reports and statistical yardsticks are vital to analyzing, evaluating, and comparing results and trends.

4.04 Physical safeguards include electronic surveillance or monitoring equipment, table drop boxes, safes, vaults, count room equipment, control over access to gaming equipment and supplies, control over keys, slot machine meters, and other mechanical devices used as part of internal control.

4.05 Locked security devices are used to accumulate and safeguard cash before the initial count of cash and the assumption of custody by the casino cashier. However, the controls in effect prior to the placement of cash in these devices at the gaming tables are largely those of direct supervision and observation of personnel, sometimes called people-watching-people checks. If casino personnel carry out their assigned duties of supervision and observation, satisfactory control can be achieved over this aspect of operations.

4.06 Systems of people watching people, including the *eye in the sky* and closed circuit television, are major components in casino internal control. To support these visual control techniques, the movement of cash should be standardized.

4.07 Human controls include continued supervision or accountability for transactions involving the purchase and redemption of chips, gaming transactions, accounts receivable transactions (credit instruments), currency counts and deposit preparation, and interpretation of financial and operating reports. As in any sound internal control, segregation of duties is of paramount importance in the overall control considerations.

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* Refer to the Preface of this Guide for important information about the applicability of the professional standards to audits of issuers and non-issuers (see definitions in the Preface). As applicable, this chapter contains dual referencing to both the AICPA and the PCAOB's professional standards.

Information Technology

4.08 Many aspects of a casino's accounting system may be computerized. Common computer applications include credit systems, slot machine systems, master game reports, race and sports systems, keno systems and game server systems.[1]

Management's Responsibility for Internal Control

4.09 This section describes management's responsibility for maintaining internal control and describes some control activities that are typically found in an entity whose internal control is well-designed. The auditor's considerations is discussed later in paragraph 4.13.

4.10 Management is responsible for establishing and maintaining effective internal control.

4.11 As described in AU sec. 319, *Consideration of Internal Control in a Financial Statement Audit*, as amended (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 319), internal control is a process—effected by an entity's board of directors, management, and other personnel—designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (*a*) reliability of financial reporting, (*b*) effectiveness and efficiency of operations, and (*c*) compliance with applicable laws and regulations. Internal control consists of the following five interrelated components:

a. Control environment
b. Risk assessment
c. Control activities
d. Information and communication systems
e. Monitoring

4.12 As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission (SEC) adopted final rules requiring companies subject to the reporting requirements of the Securities Exchange Act of 1934, other than registered investment companies, to include in their annual reports a report of management on the company's internal control over financial reporting. See the SEC Web site at www.sec.gov/rules/final/33-8238.htm for the full text of the regulation. The SEC rules clarify that management's assessment and report is limited to *internal control over financial reporting*. Management is not required to consider other aspects of control, such as controls pertaining to operating efficiency. The SEC's definition of internal control encompasses the Committee of Sponsoring Organizations of the Treadway Commission (COSO) definition but the SEC does not mandate that the entity use COSO as its criteria for judging effectiveness.

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[1] AU sec. 326, *Evidential Matter*, as amended, provides guidance to auditors in auditing the financial statements of entities for which significant information is transmitted, processed, maintained, or accessed electronically. In addition, AU sec. 319, *Consideration of Internal Control in a Financial Statement Audit*, as amended (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 319), provides guidance to auditors about the effect of information technology on internal control and on the auditor's understanding of internal control and assessment of control risk.

Annual Reporting Requirements

Under the SEC rules, the company's annual Form 10-K must include:

1. *Management's Annual Report on Internal Control Over Financial Reporting*. This report on the company's internal control over financial reporting should contain:
   a. A statement of management's responsibilities for establishing and maintaining adequate internal control over financial reporting.
   b. A statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting.
   c. Management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the most recent fiscal year, including a statement as to whether or not internal control over financial reporting is effective. This discussion must include disclosure of any material weakness in the company's internal control over financial reporting identified by management. Management is not permitted to conclude that the registrant's internal control over financial reporting is effective if there are one or more material weaknesses in the company's internal control over financial reporting.
   d. A statement that the PCAOB registered public accounting firm audited the financial statements included in the annual report has issued an attestation report on management's assessment of the registrant's internal control over financial reporting.
2. *Attestation Report of the Registered Public Accounting Firm*. This is the registered public accounting firm's attestation report on management's assessment of the company's internal control over financial reporting.
3. *Changes in Internal Control Over Financial Reporting*. This report must disclose any change in the company's internal control over financial reporting that has materially affected or is reasonably likely to materially affect the company's internal control over financial reporting.

Quarterly Reporting Requirements

The SEC rules also require management to evaluate any change in the entity's internal control that occurred during a fiscal quarter and that has materially affected, or is reasonably likely to materially affect, the entity's internal control over financial reporting.

Additionally, management is required to evaluate the effectiveness of the entity's "disclosure controls and procedures" and issue a report as to their effectiveness on a quarterly basis. With these rules, the SEC introduced a new term, "disclosure controls and procedures," which is different from "internal controls over financial reporting" and much broader.

As defined, "disclosure controls and procedures" encompass the controls over all material financial *and nonfinancial information* in Exchange Act reports. Information that would fall under this definition that would *not* be part of an entity's internal control over financial reporting might include the signing of a significant contract, changes in a strategic relationship, management compensation, or legal proceedings.

Auditor's Consideration of Internal Control

4.13 The auditor is interested not only in whether a casino has earned as much revenue as is reported in financial statements, but also in whether the statements report as much revenue as was actually earned; that is, the auditor is interested in the completeness assertion as well as the existence assertion described in AU sec. 326, *Evidential Matter*, as amended.[2] In making these judgments, the auditor may need to place a great deal of reliance on internal control.

4.14 When considering the internal controls in a financial statement audit for audits conducted in accordance with PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*,[†] the auditor is required to assess control risk for the relevant assertions embodied in the account balances, transaction class, and disclosure components of the financial statements (AICPA, *PCAOB Standards and Related Rules*, AU sec. 319).

4.15 Because of the lack of physical evidence supporting the completeness of the amounts to be reported as gaming revenues, the auditor normally relies on controls to support a reduction in the assessed level of control risk. If the auditor is unable to obtain sufficient competent evidential matter about the effectiveness of both the design and operation of controls that are relevant to financial statement assertions concerning gaming revenues to support an assessed level of control risk that allows the auditor to conclude that the risk of material misstatement of the balance has not been reduced to an acceptable level, the auditor may have a scope limitation and, if so, should modify his opinion accordingly. This scope limitation may exist even though procedures such as analyses of variations in operating ratios are used in auditing casinos (see Chapter 5 for a detailed discussion on analytical procedures) because these procedures often do not provide sufficient evidential matter in the absence of effective controls over gaming revenues.

Tests of Controls

4.16 An important phase of the auditor's consideration of internal control is testing of controls in order to obtain evidential matter about the effectiveness of the design and operation of controls and whether they support lower assessed levels of control risk. Procedures directed toward evaluating the effectiveness of the design of a control are concerned with whether that control is suitably designed to prevent or detect material misstatements in specific

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[2] AU sec. 326, *Evidential Matter*, as amended, provides guidance to auditors in auditing the financial statements of entities for which significant information is transmitted, processed, maintained, or accessed electronically. In addition, AU sec. 319, *Consideration of Internal Control in a Financial Statement Audit*, as amended (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 319), provides guidance to auditors about the effect of information technology on internal control and on the auditor's understanding of internal control and assessment of control risk.

[†] See the PCAOB Web site at www.pcaobus.org for information about the effective dates of these conforming amendments.

financial statement assertions. Procedures to obtain such evidential matter ordinarily include inquiries of appropriate entity personnel; inspection of documents, reports, or electronic files; and observation of the application of specific controls. For entities with complex internal control, the auditor should consider the use of flowcharts, questionnaires, or decision tables to facilitate the application of procedures directed toward evaluating the effectiveness of the design of a control. Procedures to obtain evidential matter about the effectiveness of the operation of a control are referred to as tests of controls. Tests of controls directed toward the operating effectiveness of a control are concerned with how the control (whether manual or automated) was applied, the consistency with which it was applied during the audit period, and by whom it was applied. These tests ordinarily include procedures such as inquiries of appropriate entity personnel; inspection of documents, reports, or electronic files, indicating performance of the control; observation of the application of the control; and reperformance of the application of the control by the auditor. In some circumstances, a specific procedure may address the effectiveness of both design and operation. However, a combination of procedures may be necessary to evaluate the effectiveness of the design or operation of a control. (For guidance on testing automated controls see paragraphs .77–.79 of AU sec. 319, *Consideration of Internal Control in a Financial Statement Audit,* as amended [AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 319].) In addition to the above, when performing an integrated audit of financial statements and internal control over financial reporting, in accordance with PCAOB standards, refer to paragraphs 104–105 of PCAOB Auditing Standard No. 2 for discussion on the extent of test of controls (AICPA, *PCAOB Standards and Related Rules*, AU sec. 319.97).

4.17 In audits of other types of entities, the extent of actual observation of routine operations and corroborative inquiries is normally confined to the periods during which the auditor is present on the client's premises to conduct other phases of his audit. This practice has proven effective in ordinary circumstances, but because of the importance of people-to-people checks in casino operations, the extent of tests of controls not involving a trail of documentary evidence is usually greater than in most other audits.

4.18 Since the auditor's tests of controls attempt to determine whether the controls are actually in effect, his observation of casino floor operations should not be announced in advance, and some phases of the observation may be undisclosed. In a similar fashion, observation of operations in the casino cage and count room should not be announced in advance even though casino security procedures will usually prevent them from being undisclosed.

4.19 In addition, these observations should be carried out at various times throughout the period under audit. Letters of introduction to casino personnel should be obtained, and arrangements should be made for prompt access to restricted areas during such visits in order to maintain the element of surprise. The precise number of visits is a matter of professional judgment. However, the length and frequency of observation normally exceed those in audits of entities in other industries and should provide the auditor with reasonable assurance that control activities were applied as prescribed during the period under audit.

Chapter 5

Analytical Procedures[*], [†]

5.01 Analytical procedures are a natural extension of the auditor's understanding of the client's business, and add to his or her understanding because the key factors that influence the client's business may be expected to affect the client's financial information. Analytical procedures are used in all three stages of the audit. In the planning stage, the purpose of analytical procedures is to assist in planning the nature, timing, and extent of auditing procedures that will be used to obtain evidential matter for specific account balances or classes of transactions.[1] In the substantive testing stage of the audit, the purpose of analytical procedures is to obtain evidence, sometimes in combination with other substantive procedures, to identify misstatements in account balances and thus to reduce the risk that misstatements will remain undetected.[2] In the overall review stage, the objective of analytical procedures is to assist the auditor in assessing the conclusions reached and in evaluating the overall financial statement presentation.

5.02 Because of the lack of documentation regarding casino revenues and the resulting inability to apply tests of details, analytical procedures are unusually important in testing casino revenues. As expressed in AU sec. 329, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 329), a basic premise underlying the application of analytical procedures is that relationships among data may reasonably be expected by the auditor to exist and continue in the absence of known conditions to the contrary. The auditor's application of analytical procedures may indicate the need to vary the extent of other auditing procedures.

5.03 When designing substantive analytical procedures, the auditor also should evaluate the risk of management override of controls. As part of this process, the auditor should evaluate whether such an override might have allowed adjustments outside of the normal period-end financial reporting process to have been made to the financial statements. Such adjustments might have resulted in artificial changes to the financial statement relationships being analyzed, causing the auditor to draw erroneous conclusions. For this reason, substantive analytical procedures alone are not well suited to detecting fraud.

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[*] For additional guidance and practical assistance regarding analytical procedures, the readers may consider referring to the AICPA Audit Guide *Analytical Procedures*.

[†] Refer to the Preface of this Guide for important information about the applicability of the professional standards to audits of issuers and non-issuers (see definitions in the Preface). As applicable, this chapter contains dual referencing to both the AICPA and the PCAOB's professional standards.

[1] Analytical procedures in the planning stage of the audit may also be useful in understanding the client's business. In understanding the business, auditors can use the results from analytical procedures to assess auditors' business risk (refer to AU sec. 312, *Audit Risk and Materiality in Conducting an Audit* [AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB Standards: AICPA, *PCAOB Standards and Related Rules*, AU sec. 312]).

[2] The auditors' use of substantive tests to achieve an audit objective related to a particular assertion may be supported by test of details, analytical procedures, or a combination. The decision about which tests to use to reduce the risk that a material misstatement will not be detected is based on the auditor's judgment about the expected effectiveness and efficiency of the available procedures (cost/benefit). For audits conducterd in accordance with PCAOB standards, the following guidance has been added: "*For significant risks of material misstatement, it is unlikely that audit evidence obtained from substantive analytical procedures alone will be sufficient*."

5.04 For audits conducted in accordance with PCAOB standards, before using results obtained from substantive analytical procedures, the auditor should either test the design and operating effectiveness of controls over financial information used in the substantive analytical procedures or perform other procedures to support the completeness and accuracy of the underlying information.

5.05 In performing analytical procedures, the auditor may analyze data from various shifts or months, or current data can be compared with prior periods' data or with internal or other available statistical data. Some factors that can be considered when applying analytical procedures include the following:

Table Games (by type)

- Win-to-drop percent
- Win per table
- Drop per table
- Comparison to statistical probability curves (regression analysis)

Slot Machines (by denomination)

- Win-to-handle percent
- Comparison of theoretical win to actual win
- Win per machine
- *Handle* per machine

Keno

- Win-to-write percent

Race and Sports Book

- Win-to-write percent

Relationships With Other Departments

- Hotel
  - — Revenue Per Available Room
  - — Average Daily Rate
  - — Win Per Room
- Conventions
- Entertainment

Relationships With Outside Conditions

- Traffic flow
- Weather
- Special events

5.06 The following are some common factors that may affect such comparisons:

Overall Factors

- Economic conditions
- Variations from industry statistics
  - — Types of clientele
  - — Size of operations
  - — Wager limits

- Seasonality of operations
- Lack of sufficient volume
- Promotional programs
- Turnover of personnel
- Changes in competition
- Change in clientele
- Change in regulatory guidelines

Table Games

- Changes in rules of the games
- Use of more decks or dealing devices
- Change in volume of credit play

Slot Machines

- Large jackpots
- Reliability of meters and readings taken
- Changes in machines or theoretical percentages
- Mechanical failures

Keno

- Changes in payout schedules
- Large payouts

Race and Sports Book

- Layoff of bets
- Adjustments of point spreads
- Limits on odds

5.07 Meaningful comparison of win-to-drop percentages for table games among casino companies can be difficult since, among other factors, some casinos include only net credit play (credit extended less payment received at the tables), rather than total credit issued, in computing drop. Win-to-drop percentages do not reflect the percentages of the total table game wagers won by the casino because drop is not the total of all wagers (an amount that is not practical to determine). The win-to-drop percentage may be affected by drop that did not generate a corresponding gaming activity. For instance, a player may purchase chips, thus creating drop, but decide not to play. This is sometimes referred to as *false drop.*

5.08 The extent of credit play and how it is recorded will also affect the comparability of ratios among casinos. If the players are permitted to pay off or make a partial payment on the credit instruments at the tables and only the resultant net credit amount is recorded as drop, the win-to-drop percentage is higher than if the players are not permitted to make a payment on the credit instruments at the tables. More extensive use of credit may cause a lower win-to-drop percentage.

5.09 Other factors that affect comparability of win-to-drop percentages are the type and experience of customers, the use of promotional items such as "lucky bucks," the differences in rules of the games, and the betting limits that are in effect.

5.10 Statistical information for the gaming industry may fluctuate more than some other industries because games are based on chance. Short-term fluctuations are not unusual, but variations over a longer term generally will not deviate from an expected range unless there have been changes in the nature or policies of the casino. Variations from an expected range should be investigated. To facilitate prompt investigation, there should be regular communication between the auditor and casino management during the year.

Chapter 6

Cash Balances and Revenue Cutoff

Introduction

6.01 A casino company's cash comprises four components:

- General bank accounts and imprest accounts, such as payroll
- Special-purpose bank accounts, such as field office accounts, that may be recorded on the general ledger individually or as part of the casino cage accountability
- Cash and cash equivalents on hand and in branch offices
- Amounts in drop boxes, gaming devices, and so on

Bank accounts normally present no unique auditing problems. This discussion is therefore directed to the remaining elements.

Components of Casino Cage Accountability

6.02 Certain assets and liabilities included in cage accountability are normally recorded on the general ledger individually; the remainder are recorded, net, in a single account. For purposes of this discussion, cash in banks, receivables, and chips in service (liability) are assumed to be recorded in separate general ledger accounts, with the balance of cage assets and liabilities being initially recorded in the casino cash-on-hand account and later reclassified. The casino cash-on-hand account normally comprises the following components:

- Currency and coins
- House chips, including reserve chips
- Personal checks, cashier's checks, and traveler's checks for deposit
- *Customer deposits,* often called customer, or front, money (The related cash is usually commingled with the casino's cash, and the customer deposits total is treated as a liability.)
- Chips of other casinos (Regulations normally prohibit acceptance of *foreign chips;* nevertheless, they may be present in the casino cage in small amounts and, in effect, represent receivables from the issuing casinos.)
- Chips on tables
- Gaming device loads (coins put into machines when they are placed in service)
- Fills and credits (These documents are treated as assets and liabilities, respectively, of the casino cage during a business day because they evidence the transfer, in or out, of assets. When win or loss is recorded at the end of the business day, they are removed from accountability.)

Some of the items listed above would be physically located outside the casino cage (for example, at change booths or in the coin room, the race and sports book, the keno desk, or branch offices).

6.03 For financial statement presentation, certain amounts are reclassified unless immaterial. Chips on hand are offset against chips in service; thevadjust net liability represents chips held by customers. Customer deposits are reclassified to a current liability account. Foreign chips are reclassified as receivables

Casino Cage Procedures

6.04 Transactions of the casino cage include (*a*) undocumented even exchanges of assets—cash for chips and (*b*) documented transfers of assets—chips for fill slips, credit slips for chips or credit instruments, cash or chips for credit instruments, or customer money receipts for cash or chips. Even exchanges are controlled by the use of imprest funds within the casino cage accountability and by supervisory observation. Documented transfers are controlled by multiple participation in transactions, and they are evidenced by the participants' signatures on documents as well as by supervisory observation.

6.05 Components of cage accountability are counted at the end of each shift. The count is made jointly by the outgoing and incoming custodians of a particular component, sometimes observed by a supervisor, and recorded on a *cash count sheet.* The count total is then reconciled to accountability at the beginning of the shift. Reconciling items may include win or loss determined by count of gaming proceeds transferred from the count rooms, deposits to or transfers from bank accounts, customer deposits, and amounts paid out for promotional items.

Tests of Accountability

6.06 Tests of casino cage accountability are similar to those performed for a bank or other financial institution. The most important aspect is simultaneous audit control of all accountability components to prevent a double count or substitution among the various assets. The components of casino cage accountability, including receivables, are usually counted simultaneously; and such a count is usually done at the balance sheet date, although in those instances in which conditions justify it (see Chapter 3), the counts may be made at an earlier or later date. In some instances conditions may justify testing of receivables at a different date from other components of accountability. If the count is at a date other than the balance sheet date, changes in balances between the count and the balance sheet date should be subjected to analytical procedures and tests of details (see Chapter 5 of this Guide for examples of industry specific analytical procedures).

6.07 The casino count procedures may be both complex and time-consuming. The count may be performed while the casino is in operation, normally at the changing of a shift. Because timing is of particular importance, the observation of the casino count procedures should be adequately planned by the auditor. It is important to know the types of items that constitute the total cage accountability, their locations, and the custodians. The auditor should also determine if there is any cash in the casino cage that is not included in the cage accountability.

6.08 The number of staff assigned to a cash count is also a consideration. There should be enough auditors to simultaneously control all material components of the accountability until they are counted.

6.09 Auditing procedures for cash and chips consist primarily of observation of the casino's normal closing procedures, that is, counting and recording of assets. Currency counting procedures, however, do not normally include counting each bill, but rather counting and testing bundles of bills. The auditor will normally want to fan bundles of large bills to determine that all are of the same denomination. Coins and chips will normally be similarly tested.

6.10 The count of reserve chips is often a time-consuming process and can usually be made at a less busy time, provided the container in which these chips are located can be sealed or otherwise controlled by the auditor.

6.11 Customer money receipts are usually sequentially prenumbered so that outstanding receipts and the related dollar amounts can be determined by referring to a log accounting for used and unused receipts on hand.

6.12 Personal checks, cashier's checks, and traveler's checks for deposit should be examined on a test basis and totaled. Checks for deposit should be kept under audit control until they are delivered to the bank or picked up by armored car. The auditor may also wish to have his client advise the bank to notify the auditor directly of any dishonored or returned items from that deposit.

Cutoff Procedures

6.13 Most casino revenue, unlike revenue of most other businesses, is not recorded in the accounting records at the time a transaction occurs. The results of customer wagers are recorded when the win for each table, machine, and so on is determined, that is, at the time the drop box contents or other receipts are counted. This count may be several hours after the wagers were made and at a time other than at shift end. Therefore, in addition to cash and equivalents already included in the casino cage accountability at the time of the count, proceeds of gaming activities for the final shift on the count date should be tested to establish the existence of the cash and credit instruments. The auditor should obtain reasonable assurance that proceeds of gaming activities not included in the casino cage accountability are not used to cover a shortage.

6.14 Many casinos operate twenty-four hours a day. Since play is continuous, it is not often practical to establish precisely the same cutoff times for the casino cage count and for all games and machines. To remove the contents of all gaming devices and to remove drop boxes at table games, for instance, usually requires several hours. An important consideration for the casino and the auditor is reasonable assurance that revenue is recorded properly and that the cutoff plan is adequate and consistent from year to year, to minimize revenue fluctuations related to cutoff. Particular care should be taken if the final day of the year is a busy day, such as New Year's Eve.

Table Games

6.15 At the time of the cutoff the auditor may wish to witness the inventorying of chips and tokens at the tables. As is usually done at each shift change, play is momentarily stopped at each table as this inventory is taken. Immediately after the inventory is taken and before play resumes, the drop box is removed from the table and taken to the count room. The auditor may wish to observe the inventory and record inventory test counts in order to later trace them to count documentation. He may also wish to observe the removal of drop boxes until they are stored and locked in the count room.

6.16 A proper cutoff of credit instrument balances at the time of the count is also necessary. The auditor's primary consideration in this regard should be that credit instrument balances, including credit extended for which credit instruments have not been issued, are determined as of the same time that the revenue is cut off. Instruments in the casino pit at the time of the count may not be physically transferred to the casino cage and exchanged for credit slips until several hours after the cutoff. These credit slips, however, will be retroactively recorded as of the time of the count, and the related instruments will be included in accountability as of that time. To establish that instrument transactions are recorded in the proper accounting period, the auditor may wish to remain in the pit until all instruments from the closed shift are transferred.

Coin-Operated Gaming Devices

6.17 If the count of coin-operated gaming devices is at a later date than the cutoff and a prorated portion of this drop is to be included in revenue, the auditor may wish to observe the removal of drop buckets, the reading of machine meters, and the transfer of the drop buckets to the coin room. He may also wish to determine that there is a proper cutoff of gaming device fills, manual jackpot payout vouchers, and progressive slot machine jackpot liabilities, both in the casino cage and in any change booths or other locations where such records may be kept.

Other Games

6.18 Keno and bingo cutoff testing requires observation of closing procedures at the keno and bingo desks. These procedures include a count of all cash on hand and the preparation of a request for credit or fill for the difference between the amount of cash on hand and the imprest amount of cash. The credit or fill will be included in casino cage accountability as of the time of the count. Since the desk was returned to its imprest amount as of that hour, win or loss for the game will be net of credits and fills, including credits or fills during the shift.

6.19 Race and sports book cutoff and testing are similar to that for keno and bingo, although to determine win or loss, revenues are adjusted for the net change in wagers with results that have not been determined.

6.20 Card room operating procedures will dictate appropriate cutoff procedures and testing. The cutoff and revenue (rake) determination will normally be similar to that for table games.

Count Procedures

6.21 The count of proceeds for the final shift preceding the cutoff time will normally be made during business hours of the following business day. Count procedures, all of which would normally be observed by the auditor, are as follows:

- The drop boxes are removed from the locked area in which they are stored.
- The cash contents of a box are removed, counted (by hand or by the use of a currency counting machine), and recorded; other documents are removed and recorded. If a currency counting machine has been used to assist in the counting of cash, the auditor should consider the machine's accuracy.

- Documents in the box—fill slips, credit slips, opening and closing table inventory slips, and in some cases credit instrument stubs or copies—are compared to lists or copies of such documents prepared by casino cage personnel. (These procedures may be performed by accounting department personnel rather than by the count team.)

All procedures are performed by the count team for each box before the next box is opened. The procedures are repeated until the contents of all boxes have been counted.

6.22 Once cash proceeds are counted and recorded by the count team and documents removed from the drop box are checked, win or loss can be determined. This determination is made by either the count team or the accounting department and is done using a form called the master game report (stiff sheet).

6.23 When the count team completes its work, members of the team sign the count sheet, the count proceeds are transferred to the casino cage, and the count sheet and documents removed from the drop boxes are transferred directly to the accounting department and not left in the custody of the cage department.

6.24 The count of gaming device proceeds is made in a similar manner, with proceeds from each machine recorded separately. Coins are normally counted by a coin machine or weighed. For this count the auditor should also consider whether the count machines or weighing devices are accurate. Procedures should be in effect to ensure that any other funds present in the count room are segregated from gaming device proceeds.

Chapter 7

Receivables*

Background

7.01 In the gaming industry, granting casino credit and collecting the resulting receivables are high-risk areas. The unique procedures involved in the approval of credit limits, the issuance of credit instruments, and the control over and collection of such instruments have long been a concern to operators, auditors, and regulators.

7.02 Although the characteristics of the gaming industry may sometimes require that the auditor use innovative methods to attain audit satisfaction, these characteristics do not reduce the need for confirmation of receivables or reduce the auditor's responsibility for satisfying himself concerning the existence and collectibility of receivables.

7.03 The auditor should understand the casino's policies for granting credit and the regulatory requirements in the jurisdiction. Credit may be extended to customers either in the casino pit or at the casino cage. Casino receivables are usually represented by executed instruments acknowledging receipt of credit, which is usually extended in the form of gaming chips. The credit instruments include markers, or IOUs; counter checks; postdated or currently dated hold checks; and returned checks.

Accounting for Casino Receivables

7.04 Several methods have been employed to determine the net amount to be reported as casino receivables. These methods have evolved from various operating practices. The key element in the selection and use of any of these methods is that the net receivable amount reported for financial statement purposes should represent the best estimate of the net realizable value of all casino receivables, considering potential bad debt and collection costs. Entities that extend trade credit to customers are included in the scope of the Statement of Position (SOP) 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*. The SOP established recognition and measurement principles and presentation and disclosure principles for such receivables. In addition, consistent with the scope of SOP 01-6, the Audit and Accounting Guide *Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies* applies to banks, savings institutions, credit unions, finance companies, and other entities (including entities with trade receivables).

7.05 Occasionally, foreign customers will pay credit instruments in the currencies of their home countries whether or not the instruments are denominated

* Refer to the Preface of this Guide for important information about the applicability of the professional standards to audits of issuers and non-issuers (see definitions in the Preface). As applicable, this chapter may contain dual referencing to both the AICPA and the PCAOB's professional standards.

in those currencies.[1] Accordingly, potential foreign exchange losses should be considered when evaluating such receivables, even if the credit instrument is denominated in U.S. dollars. Any restrictions on foreign currency transactions should also be considered in the estimation of net realizable value of receivables.

Legal Status

7.06 The legal status of various types of casino receivables may differ, depending on the jurisdiction. It is generally legal to *collect* a casino receivable in any jurisdiction, although it may not be possible to *enforce* collection in the courts.

Control Activities

7.07 Casino receivables are controllable, and procedures can be implemented to establish control over authorization (that is, extending credit and setting credit limits) and to create an appropriate trail of documentary evidence for this phase of credit operations. No attempt is made here to describe satisfactory procedures in detail. In general, the procedures should require either that an initial record of accountability is created when credit is extended to customers or that sufficient documentation of credit extension is established through the use of prenumbered, multipart forms.

7.08 Regardless of the form of instrument evidencing a casino receivable and the place of origination (pit or casino cage), certain controls over the issuance and collection of casino receivables are characteristic of effective internal control. The following controls are relevant regardless of the method of processing data (real time, batch, or manual) that is used for recording transactions:

- Accountability for receivables should be established at the time chips are advanced to patrons or as soon thereafter as is practical.
- Responsibility for the custody of instruments evidencing casino receivables, the accountability for them, and the receipt of collections should be separated as soon as practical.
- Tabulation of the receivable amount should be performed at either the end of each shift or the end of each day, and it should be compared to recorded accountability.
- Periodic examination of the instruments, preferably on a surprise basis, should be made by someone independent of the custodial function.
- Accounts submitted for write-off should be investigated by an employee independent of credit granting, custodial functions, and collection through contact with the patron. Approvals of write-offs will generally be made by the credit manager, the casino manager, the controller, and the chief operating officer, although this may vary depending on the amounts involved.

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[1] FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by FASB Statement No. 123 (revised 2004), *Share-Based Payment*, FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities—an amendment of FASB Statement No. 133*, and FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities,* provide guidance on accounting for hedges of an entity's foreign currency exposure. Additional supplemental guidance may also be found in various Emerging Issues Task Force Issues and FASB Statement 133 implementation guidance.

Confirmation

7.09 AU sec. 330, *The Confirmation Process* (AICPA, *Professional Standards*, vol. 1), provides guidance about the confirmation process in audits performed in accordance with generally accepted auditing standards. The discussion that follows here supplements AU sec. 330 for matters characteristic of, or unique to, casino receivables.

7.10 Because casino documents may be in several locations and the amounts may be included in more than one accountability, an essential element of audit planning is identification of these locations and areas of accountability and maintaining control of them at the confirmation date. Control of credit instruments held in the pit is particularly difficult, as advances and collections may be taking place at any or all tables at the cutoff time on the confirmation date. Care must be exercised to ensure a proper cutoff of receivables and any related chips and cash.

7.11 Factors that affect the nature, timing, and extent of confirmation procedures include the following:

- *The effectiveness of internal control.* Documents supporting casino receivables may be found in several locations and segments of the receivable balance may be included in more than one area of accountability, such as the casino pit, casino cage, branch offices, or collection agencies. Because there is a possibility that assets from one area might be used to cover shortages in another, it is generally advisable to consider all casino receivables as one population to be confirmed as of a single date. Controls may be different for each area; accordingly, the effectiveness of internal control for each should be considered separately.
- *The possibility of disputes and the possibility that debtors will be unable to confirm the information requested.* The possibility of disputes and the possible inability to confirm information are greater than normal in casino operations because customers do not generally receive copies of documents evidencing indebtedness; they rely primarily on their own records, if any, or on their memories.
- *Customers' knowledge of components of account balances.* Confirmation procedures may be directed to account balances or to individual items included in such balances. While casino customers' balances may include several separately executed instruments, it is likely that the customers will be able to confirm only their account balances. They do not generally know, nor do they usually have records of, the individual components of their balances.

7.12 Casino customers may be more sensitive to contact about their accounts than customers in other businesses. Customers' true names may not be in the customers' credit files (generally, though, such records are maintained), or the record of their true names may be kept elsewhere. Customers may have requested that they not receive mail or, perhaps, not be contacted at all regarding their accounts. Such situations require care by the auditor and cooperation from management so that the casino customers are not alienated and so that the auditor can satisfactorily confirm the accounts, thus avoiding a possible significant limitation on the scope of his audit.

7.13 When confirming casino receivables, it is important that the accounts confirmed include items that have been written off and items settled for less than face value during the period under audit.

Mail Circularization

7.14 A customer's credit file usually includes (*a*) a credit application completed, at least partially, by the customer; (*b*) notations of credit verification; (*c*) transactions history; and (*d*) documentation of collection efforts. In some instances the file may contain no further evidence of the validity of addresses, and despite the casino's best efforts, the addresses may be out of date. Unless there is an indication in the file, casino employees, rather than the auditor, should usually determine whether mail should be sent to the customer's home or to his business address. For the auditor to satisfy himself about the validity of the address and to reduce the number of confirmation requests returned by the postal service, he should consider independent substantiation of the address by use of the telephone directory or a name-to-address cross-reference directory and by use of registered mail. For foreign residents the auditor should consider the postal service procedures that may be applicable, such as whether undeliverable mail is returned to its sender.

Telephone Confirmation

7.15 Telephone contacts are normally limited to situations in which management or customers have indicated that there be no mail contact regarding the accounts or when customers have not replied to mail requests. Because telephone contacts do not produce any external evidence of confirmation, the auditor should exercise particular care to document these telephone conversations. The auditor should also consider independent verification of the telephone number called; this can normally be done by use of the telephone directory or directory assistance. In addition, when a client employee is involved in placing the call (for introduction purposes), the auditor should ascertain that the proper number is called.

Face-to-Face Contact

7.16 Personal contact either at or away from the casino is normally necessary only when management or the customer have indicated that no mail contact and, perhaps, no telephone contact be made. The auditor's primary concern with such contacts should be satisfaction regarding the customer's identity and documentation of the confirmation.

Alternative Procedures When No Reply Is Received

7.17 The primary documentary evidence of a casino receivable is the executed credit instrument. Normally the auditor applies alternative procedures only after he has determined that no reply to his confirmation request is likely to be received. However, when the casino customer pays his account, the instrument is generally returned to him, and sometimes the casino may not retain a copy. It is therefore advisable to examine the executed instruments for all accounts selected for circularization at the confirmation date. In the gaming industry the alternative procedure of reviewing subsequent cash receipts is of limited usefulness for establishing the existence of receivables because payments are often made in the form of currency, personal checks, chips, and cash equivalents. The casino retains little or no documentation for such payments. To overcome this problem, the auditor may request that copies of checks, money orders, and so on be made to permit subsequent review and identification of collections of specific patrons' accounts. The auditor may also arrange to be notified if a large collection is being received when he is on the client's premises so that he may observe the collection.

Branch Offices

7.18 Many casinos have branch offices located in major domestic and foreign cities. These offices are regional centers and may be responsible for certain casino activities, including the collection of credit instruments from customers. Since the staff in such offices is usually small, there is little, if any, segregation of duties among cash collection, record keeping, and records and cash transmission functions. In such instances the branch may maintain the original credit instrument and casino receivable records that duplicate certain records of the casino accounting system. The credit instruments located at the branches are subject to the tests previously described. Accordingly, the auditor's visits to selected branch offices should be scheduled concurrently with the performance of tests of all credit instruments to ensure an accurate cutoff. Another objective of the visit is to determine whether the branch is remitting the collection proceeds promptly. The procedures related to this objective would include tests of cash on hand and in banks, as described in Chapter 3. In addition, the controls related to collection procedures, credit instrument safekeeping, and communication of significant credit data between the branch and the casino should be tested.

Allowance for Doubtful Accounts

7.19 Credit customers may reside in jurisdictions where collection of gaming obligations is not legally enforceable. This condition, together with the substantial number of customers with outstanding debts and the longer collection cycle experienced by casinos when compared to that of other industries, should be addressed when the auditor evaluates the collectibility of gaming credit instruments.

7.20 Practices used in establishing allowances for doubtful accounts include (*a*) review of individual accounts; (*b*) use of ageing criteria (for example, automatic inclusion of account balances in the allowance when a specified age is reached; the auditor should be alert to the effects on ageing when current credit instruments merely replace older ones); and (*c*) application of statistical experience factors. A combination of the specific review of major account balances and the application of statistical experience factors to the various ageing categories of receivable balances is the most common method of establishing the allowance. Subsequent collections are usually reviewed for large account balances in order to further test the adequacy of the allowance.

7.21 FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended, addresses the accounting by creditors for impairment of certain loans. It is applicable to all creditors and to all loans (examples include, but are not limited to, accounts receivable with terms exceeding one year and notes receivable), uncollateralized as well as collateralized, except large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, loans that are measured at fair value or at the lower of cost or fair value, leases, and debt securities as defined in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, as amended.

It applies to all loans that are restructured in a troubled debt restructuring involving a modification of terms. FASB Statement No. 114, as amended, requires that impaired loans that are within its scope be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. FASB Statement No. 114 amends FASB Statement No. 5 to clarify that a creditor should evaluate the collectibility of both contractual interest and contractual principal of all receivables when assessing the need for a loss accrual. FASB Statement No. 114, as amended, also amends FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, to require a creditor to measure all loans that are restructured in a troubled debt restructuring involving a modification of terms in accordance with FASB Statement No. 114, as amended.

Tests of Controls

7.22 Assessing control risk below the maximum level involves—

- Identifying specific controls relevant to specific assertions.
- Performing tests of controls.
- Concluding on the assessed level of control risk.

Significant controls related to authorization, transaction processing, classification, evaluation, and physical safeguarding should be tested. Often, tests of compliance with applicable regulatory criteria will also be made. For audits conducted in accordance with PCAOB standards, PCAOB Auditing Standard No. 2 (AICPA, *PCAOB Standards and Related Rules*, AU sec. 319.65) states, in part, that "*if the auditor assesses control risk as other than low for certain assertions or significant accounts, the auditor should document the reasons for that conclusion*." Accordingly, if control risk is assessed at the maximum level, the auditor should document the basis for that conclusion. Refer to paragraphs 159–161 of PCAOB Auditing Standard No. 2 for additional information regarding documentation requirements.

Chapter 8

Illustrative Financial Statements

8.01 The sample financial statements of a hotel-casino[1] that follow are illustrative only and are not intended to establish requirements for reporting. In addition, the amounts shown are not intended to indicate any customary relationship among accounts.

8.02 The notes to the financial statements indicate the subject matter unique to casinos that is generally disclosed, but such disclosures should be modified to suit individual circumstances as well as materiality considerations. These sample financial statements may not include all disclosures and presentation items promulgated, nor do they represent minimum standards or requirements. Preparers and auditors of SEC-registrant financial statements should be aware that there may be certain disclosures required to be made in addition to those required by generally accepted accounting principles. Those additional requirements are not presented in these illustrative financial statements because they are not otherwise required by generally accepted accounting principles. In addition to the illustrative notes that are presented, the notes to financial statements of a casino should include any other appropriate disclosures required by generally accepted accounting principles. Such disclosures might include, among other items, information concerning related-party transactions, subsequent events, pension plans, postretirement benefits other than pensions, postemployment benefits, share based payment transactions, lease commitments, extraordinary items, accounting changes, off-balance-sheet risks, concentrations of credit risk, the fair value of financial instruments, and other matters that are not unique to casinos.

8.03 The sample financial statements and notes follow in paragraphs 8.05 through 8.08.

[1] This Guide does not discuss accounting and auditing for the hotel industry. The inclusion of the hotel in the sample financial statements is for illustrative purposes only.

8.04

Independent Auditor's Report

The Stockholders and Board of Directors
ABC Casinos, Inc.

We have audited the accompanying balance sheets of ABC Casinos, Inc. as of December 31, 20X4 and 20X3, and the related statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.*][2] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Casinos, Inc. as of [at] December 31, 20X4 and 20X3, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

____
[*Firm Signature*]
Certified Public Accountants

City, State
February 18, 20X5

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[2] This optional wording may be added in accordance with Interpretation No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of SAS No. 58, which was issued by the ASB in June 2004 and provides reporting guidance for audits of nonissuers. Interpretation No. 17 addresses how auditors may expand their independent audit report to explain that their consideration of internal control was sufficient to provide the auditor sufficient understanding to plan the audit and determine the nature, timing and extent of tests to be performed, but was not sufficient to express an opinion on the effectiveness of the internal control. If this optional language is added, then the remainder of the paragraph should read as follows:

> "An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion."

Additional Guidance When Performing Integrated Audits of Financial Statements and Internal Control Over Financial Reporting:

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, the auditor may choose to issue a combined report or separate reports on the company's financial statements and on internal control over financial reporting. Refer to paragraphs 162–199 of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320), for direction about reporting on internal control over financial reporting. In addition, see Appendix A, *Illustrative Reports on Internal Control Over Financial Reporting, of PCAOB Auditing Standard No. 2*, for an illustrative combined audit report and examples of separate reports (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 508.01).*

If the auditor issues separate reports on the company's financial statements and on internal control over financial reporting, the following paragraph should be added to the auditor's report on the company's financial statements (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 508.08):*

> "We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of X Company's internal control over financial reporting as of December 31, 20X4, based on [*identify control criteria*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinions*]."

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, the auditor's report on the company's financial statements and on internal control over financial reporting should be dated the same date. Refer to paragraphs 171–172 of PCAOB Auditing Standard No. 2 for direction about the report date in an audit of internal control over financial reporting (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 530.01).*

* See the PCAOB Web site at www.pcaobus.org for information about the effective dates of the conforming amendments.

8.05

ABC Casino, Inc.
Balance Sheets

	December 31	
Assets	20X4	20X3
Current assets		
Cash and cash equivalents	$ 2,678,300	$ 2,287,100
Marketable securities	1,000,000	500,000
Accounts receivable, less allowance for uncollectible accounts of $500,000 and $470,000	1,800,100	1,695,200
Other current assets	240,700	229,100
Total current assets	5,719,100	4,711,400
Property and equipment, at cost		
Land	2,201,100	2,201,100
Buildings	27,602,300	27,602,300
Furniture and equipment	9,581,100	8,995,200
Total	39,384,500	38,798,600
Less accumulated depreciation	9,000,600	7,803,500
Net property and equipment	30,383,900	30,995,100
Other assets and deferred charges	1,300,000	1,200,000
Total assets	$37,403,000	$36,906,500
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	$ 1,000,000	$ 1,200,000
Accounts payable	928,600	839,200
Deferred income taxes	450,075	375,000
Income taxes payable	150,000	161,000
Other	344,400	207,600
Total current liabilities	2,873,075	2,782,800
Long-term debt, less current portion	15,800,000	16,300,000
Deferred income taxes	618,125	501,000
Total liabilities	19,291,200	19,583,800
Stockholders' equity		
Common stock ($1 par value 1,000,000 shares authorized, issued, and outstanding)	1,000,000	1,000,000
Capital in excess of par value	6,495,800	6,495,800
Retained earnings	10,616,000	9,826,900
Total stockholders' equity	18,111,800	17,322,700
Total liabilities and stockholders' equity	$37,403,000	$36,906,500

The accompanying notes are an integral part of the financial statements.

8.06

ABC Casino, Inc.

Statements of Income and Retained Earnings

	Year ended December 31	
	20X4	*20X3*
Revenue		
Casino	$ 12,802,300	$ 11,532,100
Room	2,100,600	1,827,200
Food and Beverage	1,990,900	1,781,800
Total revenues	16,893,800	15,141,100
Costs and expenses		
Operating departments	7,712,100	6,817,600
Selling, general, and administrative	3,021,900	2,707,700
Interest	2,050,300	1,935,300
Depreciation and amortization	1,900,200	1,692,100
Total costs and expenses	14,684,500	13,152,700
Income before income taxes	2,209,300	1,988,400
Provision for income taxes	970,200	818,000
Net income[3] ($1.24 and $1.17 basic earnings per share)[4]	1,239,100	1,170,400
Retained earnings, January 1	9,826,900	9,106,500
Dividends ($.45 per share in each year)	(450,000)	(450,000)
Retained earnings, December 31	$ 10,616,000	$ 9,826,900

The accompanying notes are an integral part of the financial statements.

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[3] FASB Statement No. 130, *Reporting Comprehensive Income*, establishes standards for the reporting and display of comprehensive income and its components. The Statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The Statement does not require a specific format for that financial statement but requires that an enterprise display an amount representing total comprehensive income for the period in that financial statement. The Statement does not apply to an enterprise that has no items of other comprehensive income in any period presented.

[4] FASB Statement No. 128, *Earnings per Share*, as amended by FASB Statement No. 123 (revised 2004) *Share-Based Payment*, establishes standards for computing and presenting earnings per share (EPS) and applies to entities with publicly held common stock or potential common stock. It requires dual presentation of basic and diluted EPS on the face of the income statement for all entities with complex capital structures and requires a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation.

8.07

ABC Casino, Inc.

Statements of Cash Flows

	Years ended December 31	
	20X4	*20X3*
Cash flows from operating activities:		
Net income	$ 1,239,100	$ 1,170,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,900,200	1,692,100
Provisions for losses on accounts receivable	30,000	20,000
Deferred income taxes	192,200	205,500
Change in noncash assets and liabilities:		
Accounts receivable	(134,900)	(134,400)
Other assets	(111,600)	27,500
Accounts payable	89,400	38,500
Income taxes	(11,000)	(18,300)
Other liabilities	136,800	74,200
Net cash provided by operating activities	3,330,200	3,075,500
Cash flows from investing activities:		
Purchases of marketable securities	(500,000)	(500,000)
Proceeds from sale of furniture & equipment	6,200	437,300
Payments for purchases	(1,295,200)	(435,200)
Net cash used by investing activities	(1,789,000)	(497,900)
Cash flows from financing activities:		
Repayment of long-term debt	(700,000)	(1,000,000)
Dividends	(450,000)	(450,000)
Net cash used in financing activities	(1,150,000)	(1,450,000)
Net increase in cash and cash equivalents	391,200	1,127,600
Cash and cash equivalents at beginning of year	2,287,100	1,159,500
Cash and cash equivalents at end of year	$ 2,678,300	$ 2,287,100
Supplemental disclosure of cash flow data:		
Cash paid during the years for:		
Interest (net of amounts capitalized)	$ 1,500,000	$ 1,320,000
Income taxes	$789,000	$ 634,300

The accompanying notes are an integral part of the financial statements.

8.08

ABC Casino, Inc.

NOTES TO FINANCIAL STATEMENTS

1. *Nature of Operations and Summary of Significant Accounting Policies*[5]

Nature of operations. The company provides gaming and lodging services through the ownership and operation of casino-hotel resorts in Atlantic City, New Jersey and in Las Vegas, Nevada. The major source of the company's revenues is derived from gaming operations.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash equivalents. The company considers all highly liquid debt instruments purchased with a maturity of three months or less when purchased to be cash equivalents.

Casino revenue. Casino revenue is the net win from gaming activities, which is the difference between gaming wins and losses.

Property and equipment, Depreciation and amortization of property and equipment are computed using the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the life of the related asset or the life of the lease, whichever is shorter.

Long-lived assets. Long-lived assets to be held and used are tested for recoverability whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the fair value of the asset. Certain long-lived assets to be disposed of by sale are reported at the lower of carrying amount or fair value less cost to sell.

Marketable securities. Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determination at each balance sheet date. Debt securities for which the Company does not have the intent or ability to hold to maturity are classified as available for sale, along with the Company's investment in equity securities. Securities classified as available for sale are carried at fair value, with unrealized gains and losses, if any, reported, net of tax, in other comprehensive income until realized.

The amortized cost of debt securities classified as available for sale is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and interest are included in interest income. Realized gains and losses are included in other income or expense. The cost of securities sold is based on the specific identification method.

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[5] SOP 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*, requires certain disclosures to be made in the summary of significant accounting policies related to accounting policies for loans and trade receivables. See paragraph 13 of the SOP for guidance. Consistent with the scope of SOP 01-6, the Audit and Accounting Guide *Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies* applies to banks, savings institutions, credit unions, finance companies, and other entities (including entities with trade receivables).

Preopening costs. Certain costs incurred in connection with the development and opening of the casino have been charged to expense as incurred.

Income taxes. Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed in FASB Statement No. 109,[6] *Accounting for Income Taxes*. As changes in tax laws or rate are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Basic earnings per share. Basic earnings per share of common stock were computed by dividing income available to common stockholders, by the weighted average number of common shares outstanding for the year. Diluted earnings per share are not presented because the Company has issued no dilutive potential common shares.

2. *Accounts Receivable* [7]

Accounts receivable comprise the following:

	Gaming	Other	Total
20X4			
Accounts receivable	$ 2,050,100	$ 250,000	$ 2,300,100
Less allowance	440,000	60,000	500,000
Net	$ 1,610,100	$ 190,000	$ 1,800,100
20X3			
Accounts receivable	$ 1,994,200	$ 171,000	$ 2,165,200
Less allowance	431,000	39,000	470,000
Net	$ 1,563,200	$ 132,000	$ 1,695,200

Receivables consist primarily of large groups of smaller-balance homogeneous accounts that are collectively evaluated for impairment, accordingly, the provisions of FASB Statement No. 114, as amended, do not apply.

3. *Promotional Allowances*

Revenue does not include the retail amount of rooms, food, and beverage provided gratuitously to customers, which was $2,109,400 and $1,858,400 in 20X4 and 20X3, respectively.

4. *Income Taxes*

The provision for income taxes consists of the following:

[6] In December of 2004, the FASB directed its staff to issue two FASB Staff Positions (FSP): FSP FAS 109-1, *Application of FASB Statement No. 109*, Accounting for Income Taxes, *for the Tax Deduction Provided to U.S. Based Manufacturers by the American Jobs Creation Act of 2004* and FSP FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* to provide accounting and disclosures guidance on deductions arising from the American Jobs Creation Act of 2004. Both FSPs were effective on issuance.

[7] SOP 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*, requires certain disclosures to be made related to loans and trade receivables. See paragraph 13 of the SOP for guidance. Consistent with the scope of SOP 01-6, the Audit and Accounting Guide *Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies* applies to banks, savings institutions, credit unions, finance companies, and other entities (including entities with trade receivables).

	20X4	20X3
Current		
Federal	$725,000	$575,000
State	53,000	37,500
Total Current	778,000	612,500
Deferred		
Federal	157,000	183,425
State	35,200	22,075
Total Deferred	192,200	205,500
Total	$970,200	$818,000

The net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes are reflected in deferred income taxes. Significant components of the Company's deferred tax liabilities as of December 31, 20X4 and 20X3 are as follows:

	20X4	20X3
Current deferred tax assets/(liabilities)		
Gaming receivables	$(450,075)	$(375,000)
Noncurrent deferred tax assets (liabilities)		
Property and Equipment	$(582,875)	$(460,025)
Deferred charges	(19,900)	(22,400)
Other (net)	(15,350)	(18,575)
Total noncurrent deferred tax liability	$(618,125)	$(501,000)

A reconciliation of the income tax provision with amounts determined by applying the federal statutory rate to income before income taxes is as follows:

	20X4	20X3
Federal statutory income tax rate	34.0%	34.0%
State and local income tax	4.0	3.0
Nondeductible expenses	3.6	2.3
Other	2.6	1.5
Effective Tax Rate	43.9%	41.1%

5. *Long-Term Debt*

Long-term debt is summarized as follows:

	20X4	20X3
Notes payable to banks, 1/4 to 3/4 over prime and 8% to 9%, payable in varying installments to 2010	$8,800,000	$9,100,000
Notes payable to institutional lenders, 5 1/4% to 10 1/2%, payable to 20X9, of which $11,786,000 is secured by real property	3,500,000	3,800,000
Notes payable, other, 1% over prime, payable to 2010	4,500,000	4,600,000
Total long-term debt	16,800,000	17,500,000
Less current installments of long-term debt	1,000,000	1,200,000
Net long-term debt	$15,800,000	$16,300,000

The aggregate amounts of principal maturities of debt outstanding at December 31, 20X4, for the five subsequent years are as follows:

20X5	$1,000,000
20X6	1,957,000
20X7	991,000
20X8	896,000
20X9	778,000

6. *Marketable Securities*[8]

The following is a summary of the estimated fair value of securities classified as available for sale at December 31, 20X4 and 20X3:

Marketable securities (in thousands)

	20X4	*20X3*
U.S. Treasury obligations	$ 400	$400
Marketable equity security	500	—
Corporate debt securities	100	100
	$1,000	$500

As of December 31, 20X4 and 20X3, the estimated fair value of each investment approximates cost or amortized cost, and therefore, there are no unrealized gains or losses recorded in other comprehensive income. At December 31, 20X4, the company had no investments that were classified as trading or held-to-maturity.

At December 31, 20X4, all of the Company's investments in debt and equity securities were classified as marketable securities. These investments are diversified among high credit quality securities in accordance with the Company's investment policy.

The estimated fair value of debt securities available for sale by contractual maturity at December 31, 20X4 is as follows:

(in thousands)

	20X4
Due after three months through one year	$150
Due after one year through three years	250
Due after three years	100
	$500

Actual maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

7. *Vulnerability Due to Certain Concentrations*

The Company's casinos use custom designed slot machines obtained from a foreign manufacturer under an exclusive purchase/maintenance contract

[8] Then addressing other than temporary impairment, readers may also refer to Emerging Issues Task Force Issue No. 03-1, "The Meaning of Other Than-Temporary Impairment and Its Application to Certain Investments."

negotiated at a cost significantly lower than prevailing market prices. Recent events in the supplier's home country have created an unstable political environment which raises the possibility that the supplier may be unable to fulfill its contractual obligations. Negotiating another contract with a new supplier, at similar terms and cost, could be a time consuming process. Any extended delays in securing a new supplier could have a severe impact upon casino revenues.

8. *Fair Value of Financial Instruments*[9]

The carrying amount of the Company's current portion of long-term debt approximates fair value. The fair value of long-term debt, which is based on borrowing rates currently available to the Company for debt issues with similar terms and maturities, is $15,465 (20X3, $15,845).

9. *Property and Equipment*

Note: FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, requires certain disclosures if an impairment loss is recognized for assets to be held and used. An example of such a disclosure is shown below:

> *In conjunction with plans to expand casino floor space, the Company recently completed a slot machine upgrade at its Las Vegas casino, replacing a portion of its older slot machines with state of the art machines that contain embedded bill acceptors. The older machines have been reallocated to other casino locations operated by the Company in Atlantic City. As a result of this circumstance, and pursuant to FASB Statement No. 144,* Accounting for the Impairment or Disposal of Long-Lived Assets, *an impairment loss of approximately $X,XXX has been recognized for these slot machines and included as a component of income before income taxes under the caption "Operating departments." In calculating the impairment loss, fair value was determined by reviewing quoted market prices for current sales of similar slot machines.*

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[9] FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities—an amendment to FASB Statement No. 107*, amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to make the disclosures about fair value of financial instruments prescribed in FASB Statement No. 107 optional for entities that meet all of the following criteria:

a. The entity is a nonpublic entity.

b. The entity's total assets are less than $100 million on the date of the financial statements. The entity has no instrument that, in whole or in part, is accounted for as a derivative instrument under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities—an amendment of FASB Statement No. 133*, and FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, as amended by FASB Statement No. 123 (revised 2004), during the reporting period.

The FASB established the Derivative Implementation Group (DIG) to assist the Board and its staff in providing implementation guidance regarding FASB Statement No. 133, as amended by FASB Statement No. 138, and as amended by FASB Statement No. 149, as amended by FASB Statement No. 123 (revised 2004). Issues addressed by the DIG and the status of related guidance can be found at the FASB's Web site www.fasb.org.

Chapter 9

Internal Control Reporting[1, *]

9.01 AT sec. 501, *Reporting on an Entity's Internal Control Over Financial Reporting*, of Statement on Standards for Attestation Engagements (SSAE) No. 10, *Attestation Standards: Revision and Recodification* (AICPA, *Professional Standards*, vol. 1), provides guidance to the practitioner who is engaged to issue or who does issue an examination report on the effectiveness of an entity's internal control over financial reporting (or an assertion thereon) as of a point in time or for a period of time. AT sec. 501 does not provide guidance on engagements to examine controls over operations or compliance with laws and regulations. PCAOB Auditing Standard No. 2 and the PCAOB's *Conforming Amendments to Interim Standards* (AICPA, *PCAOB Standards and Related Rules*) supersede AT sec. 501 for engagements conducted in accordance with PCAOB standards. Readers should refer to the applicable PCAOB standards for guidance.

9.02 AU sec. 325, *Communication of Internal Control Related Matters Noted in an Audit*, as amended, provides guidance in identifying and reporting conditions that relate to an entity's internal control observed during an audit of financial statements.[2] In an audit of financial statements only, conducted in accordance with PCAOB standards, sections of AU sec. 325, as amended, have been superseded as described in *Communications About Control Deficiencies in an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, AU sec. 325). For an integrated audit of financial statements and internal control over financial reporting conducted in accordance with PCAOB Standards, AU sec. 325, as amended, has been entirely superseded by paragraphs 207–214 of PCAOB Auditing Standard No. 2 (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320.207–.214).

9.03 Reports on internal accounting control in casino engagements usually relate to (*a*) an evaluation of the design of a system before the casino begins operations and (*b*) an evaluation, in connection with the annual audit, of compliance with, deviations from, and material weaknesses in the system. The independent accountant may also be asked to comment in these reports on certain aspects of administrative controls and on compliance with certain regulations. An independent auditor may also be engaged to make recommendations to improve internal controls.

Reports on the Design of a System[3]

9.04 Regulatory agencies generally require that casinos submit a detailed description of a proposed system of internal accounting control together with an

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[1] The guidance in this chapter will be conformed to current authoritative literature in future editions as approval is obtained from applicable state regulatory agencies.

[*] Refer to the Preface of this Guide for important information about the applicability of the professional standards to audits of issuers and non-issuers (see definitions in the Preface). As applicable, this chapter contains dual referencing to both the AICPA and the PCAOB's professional standards.

[2] Readers should review the exposed proposed changes to AU sec. 325, *Communication of Internal Control Related Matters Noted in an Audit,* and to AT sec. 501, *Reporting on an Entity's Internal Control Over Financial Reporting* of SSAE No. 10, *Attestation Standards: Revision and Recodification*, as amended (AICPA, *Professional Standards*, vol. 1).

[3] The guidance for reporting on the design of a system is governed by AT sec. 501, *Reporting on an Entity's Internal Control Over Financial Reporting*, of SSAE No. 10, *Attestation Standards: Revision and Recodification* (AICPA, *Professional Standards*, vol. 1).

independent accountant's report on it. Generally the independent accountant is required to state that the submitted system conforms with the standards of internal control set forth by the agency, or he must state in what respects the system does not conform. These reports vary by jurisdiction and may require either inclusion of all departures from the standards or only those that the independent accountant considers material.

9.05 In some cases the statute and regulations may, for example, be very general and may, in effect, allow a casino the freedom to design its own system as long as the system provides reasonable assurance that certain general guidelines have been met.

9.06 On the other hand, the statute and regulations may be very specific in setting forth what controls are required. In effect, the system is designed through statute and regulations. The statute and regulations may deal with such matters as—

- Job descriptions and the personnel structure, establishing responsibilities among casino employees and identifying primary and secondary supervisory positions for areas of responsibility.
- Complimentary services and junkets.
- The receipt, storage, and disbursement of chips and cash.
- The collection and safeguarding of money and chips at the gaming tables and transfers between the tables and the cage.
- The transfer of coins to and from the slot machines.
- The opening and safeguarding of slot machines.
- Formulas covering the calculation of revenues, drop, and hold percentages.
- Accounting, auditing, and financial reporting.
- The credit system.

Reports on Compliance With the System

9.07 Casino regulations generally require an independent accountant's report on the casino's compliance with an internal control system as it is described in a filing with the regulatory agency. This report may be based on the independent accountant's study and evaluation of the casino's internal control system in connection with his audit, performed in accordance with generally accepted auditing standards, of the casino's financial statements.[4] In addition, certain regulatory agencies may require testing of compliance with the casino's system beyond what would otherwise be required to express an opinion on the casino's financial statements.

9.08 The regulations may provide that the independent accountant issue a report stating whether his audit disclosed any material weaknesses in internal control (as defined in AU sec. 325, as amended (AICPA, *Professional Standards*, vol. 1, and for audits conducted in accordance with PCAOB standards: AICPA, *PCAOB Standards and Related Rules*, AU secs. 325 and 9325). If there are any instances or procedures that came to the attention of the independent accountant that he believes to be weaknesses or that are not in conformity

[4] See paragraphs 9.01 and 9.02.

with the description of the system as filed, he would also have to (*a*) describe such deviations, regardless of materiality, and (*b*) make recommendations for improvements in internal control.

9.09 The reports on internal accounting control required under such regulations present special planning considerations for the auditor, particularly in situations where the approved system of internal accounting control may be amended many times throughout the year. Tests of controls for audit purposes are often integrated with compliance testing for regulatory purposes. When performing an integrated audit of financial statements and internal control over financial reporting, in accordance with PCAOB standards, refer to paragraphs 104–105 of PCAOB Auditing Standard No. 2 for discussion on the extent of test of controls (AICPA, *PCAOB Standards and Related Rules*, AU sec. 319.97).

Appendix A

Management Control Objectives of Certain Casino Operations[1]

The following items illustrate control objectives and techniques for certain functions unique to casinos that management may wish to consider in establishing specific controls concerning a casino's ability to record, process, summarize, and report financial data that is consistent with management's assertions embodied in financial statements. They are not intended to be all-inclusive but are intended to illustrate certain control objectives and techniques that are usually significant.

Granting of Credit

Establishment of Credit Lines and Maintenance of Credit Files

- Controls exist to ensure that establishment of customer credit is authorized in accordance with the system.
  - — Adequate segregation of duties exists between the functions of establishing credit lines, extending credit, and collecting credit.
  - — The integrity of credit files is protected and the data are sufficiently reviewed to ensure proper recording of additions and deletions and to preclude unauthorized alteration of information.
  - — Procedures exist to obtain and adequately verify information such as name, address, and bank references provided by applicants.
  - — Proper authorization, varying by credit amount requested, is required to establish or increase credit lines.
  - — Credit files indicate an approved credit limit.
  - — Credit files are periodically reviewed for completeness of required information, and required verification procedures are used.
  - — Access to critical forms, records, and processing areas is permitted only in accordance with established criteria.

Extension of Credit

- Controls exist to ensure that procedures are maintained in accordance with management's policies.
  - — There is a clear statement of procedures (that is, procedural manuals, training routines, supervisory requirements, and so on exist).
- Only those credit requests that meet management's criteria are granted.
  - — There are formal procedures for determining whether a customer has an approved credit line and whether it has been exceeded.
  - — There is designation of those individuals who may process credit-request clearances.

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[1] For additional discussion concerning management's responsibility for internal control please refer to Chapter 4, paragraphs 4.09–4.12.

- — There are exception-reporting procedures (for example, over credit limit, unpaid old balances, and so on).
- — Procedures are adequate to safeguard the integrity of pit and casino cashier credit files.
- — There is appropriate supervision of credit extension activities, including supervisory approval of transactions.
- — Credit instruments are prenumbered, and there is subsequent accountability for them.
- — Unissued credit instrument forms are adequately safeguarded.
- — There is adequate segregation of duties among employees involved in granting credit and issuing the credit instruments.
- — Customers acknowledge credit by signing the credit instruments.
- — There is timely preparation of receivable records for subsequent accountability.
- — Where credit play occurs prior to the formal documentation of a credit transaction, there are adequate interim procedures to control credit extension.

Recording of Credit Transactions

- Each credit transaction is promptly and accurately recorded in appropriate credit records.

Custody of Credit Instruments

- Credit instruments are adequately safeguarded.
- There are periodic reconciliations, in detail and in total, of the actual credit instruments to the records.
- There is adequate segregation of duties between employees responsible for custody of credit instruments and those responsible for credit authorization and collection.

Table Games

Fills and Credits

- Only those requests for transfers to or from table inventory that meet management's criteria are approved.
- Transfers to or from table inventory should be accurately and promptly recorded.
- Prenumbered slips are used for fills or credits.
  - — The slips are used in numerical sequence and accounted for by the accounting department; missing numbers are investigated.
  - — The slips are stamped with the date and the time.
  - — All voided slips are clearly marked "void" across the face of the slip and are signed[2] by the cashier and the runner.
  - — The fill or credit amount is transferred only when accompanied by a slip.

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[2] Throughout this appendix, where a control objective indicates that a document should be signed, an implicit control procedure is that the presence and the authenticity of the signature is checked by another employee.

— The person physically transferring the fill or credit is independent of the transaction (for example, security personnel).
— The slip is signed by the cashier, the runner, the dealer, and the supervisor after the amount of the fill or credit is agreed to the amount on the slip.

- Access to table inventories should be permitted only in accordance with management's criteria.

  — All fills and credits are counted at the table prior to being placed in the table tray or the racks for transfer to the cage.
  — *Lammer buttons* are removed only by the dealer.

- Access to important forms and processing areas should be permitted only in accordance with management's criteria.

  — All unissued fill or credit slips are securely stored under the control of the accounting or security department.
  — All unissued fill or credit slips are controlled by log and are agreed to fill or credit slip purchase invoices by the accounting department.

Table Inventories

- Gaming chips are removed from the table inventory only—

  — In exchange for credit slips from the casino cage.
  — In exchange for cash, credit instruments, or chips from customers.
  — In payment of winning wagers.

- Inventories for tables not in use are under adequate physical control.
- Chips are counted and stored in locked containers attached to the gaming table or stored in another secure area.

Count Procedures

- Physical safeguards present.

  — Surveillance monitoring of the drop and count processes.
  — Security involvement with the drop process.
  — Drop boxes and count rooms are controlled and restricted to appropriate personnel.

- The contents of drop boxes are counted at least daily.

  — Drop boxes are adequately secured until the contents are counted.
  — The contents of each drop box are counted by count teams consisting of employees with no incompatible functions.
  — Count teams are adequately supervised.

- Counts are recorded promptly and accurately.

  — Counts are recorded on count sheets posted to the master game report, which is sent to the accounting department.
  — Members of the count team sign the master game report.

- Receipts are transferred to the casino cage immediately following the count and agreed to the recorded count.

Slot Machines

Fills and Credits

- Only those requests for transfers of cash or tokens to or from inventory that meet management's criteria are approved.
- Transfers of cash or tokens to or from inventory should be accurately and promptly recorded.
- Prenumbered slips are used for transfers.
  - — The slips are used in numerical sequence and accounted for by the accounting department; missing numbers are investigated.
  - — The slips are stamped with the date and the time.
  - — All voided slips are clearly marked "void" across the face of the slip and are signed by the cashier and the runner.
  - — The cash or tokens are transferred only when accompanied by a slip.
  - — The slip is signed by the cashier, the runner, and the slot supervisor after agreeing the amount of the fill or credit to the amount on the slip.
- Access to cash and tokens should be permitted only in accordance with management's criteria.
  - — All cash and tokens are transported directly to or from the cage by members of the security department.
  - — Slot fills are placed in the slot machines by slot mechanics or employees of the security department.
  - — Slot fills are witnessed by the slot supervisor or the key person.
- Access to important forms and processing areas should be permitted only in accordance with management's criteria.
  - — All unissued fill or credit slips are securely stored under the control of the accounting department.
  - — All unissued fill or credit slips are controlled by log and are agreed to fill or credit slip purchase invoices by the accounting department.

Slot Booth Cashier Funds

- Funds, which are imprest, are counted regularly at each shift change by incoming and outgoing custodians.
- Access to the slot booth is restricted.
- Manual jackpot payouts are documented. (This documentation consists of the signatures of two people—a slot supervisor and another independent person.)

Count Procedures

Physical safeguards present.

- — Surveillance monitoring of the drop and count processes.
- — Security involvement with the drop process.
- — Drop boxes and count rooms are controlled and restricted to appropriate personnel.

- Drop buckets are collected and counted on a regular basis.
  - — Scales are tested regularly.
  - — The count is performed by count teams consisting of employees with no incompatible functions.
  - — If *weigh* and *wrap counts* are made, they are compared and differences are reconciled.
  - — Count teams are adequately supervised.
  - — Other funds present at the time of the count are adequately segregated.
- Counts are recorded promptly and accurately.
  - — Counts are recorded on count sheets.
  - — Members of the count team sign the count sheets.
  - — Count sheets are posted to the slot win sheet by the accounting department.
  - — The count is compared to meter readings, if any, and differences are investigated.
  - — Coins are transferred to the casino cage immediately following the count, and they are agreed to the recorded count.

Appendix B

Illustrative Internal Accounting Control Reports

Note: The guidance in this appendix has been eliminated due to obsolescence. Future editions of this guide will contain current authoritative literature after approval from applicable state regulatory agencies has been obtained.

Appendix C

Rules of the Games

This appendix describes the rules of various games commonly found in a casino. The descriptions are intended to be representative, but the rules, odds, and payoffs often differ, depending on the particular casino and its location.

Craps

Method of Play

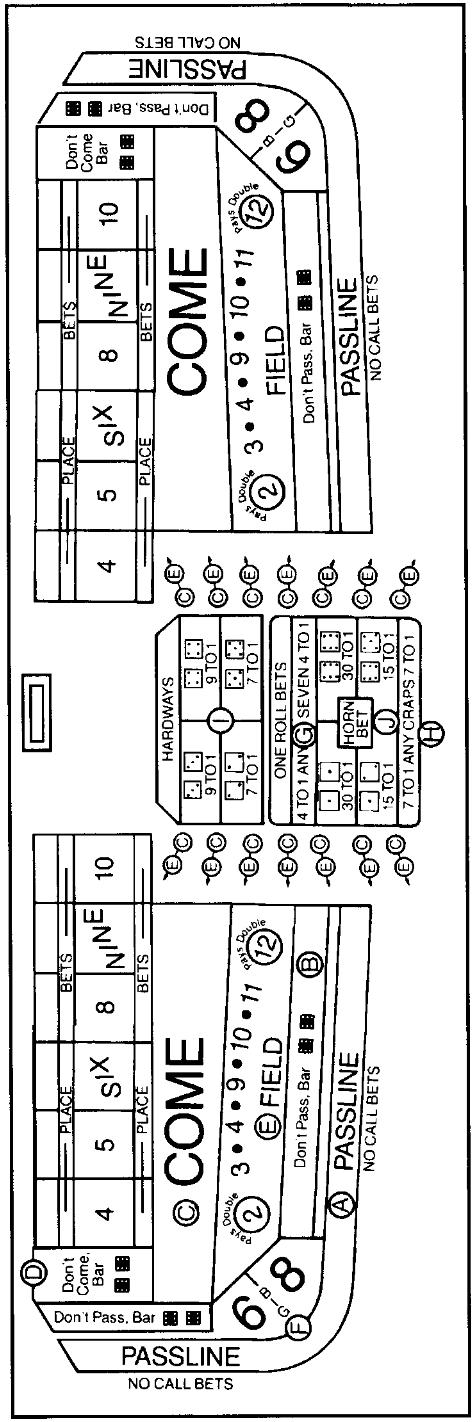
Craps is played on a large table and offers a variety of bets. Each bet is dependent upon the point value of the uppermost sides of two dice that come to rest after having been thrown by the *shooter.* Refer to the diagram of the craps table layout on the following page for placement of various bets.

Pass Line (A). If a player places a bet on the Pass Line and the first roll of the dice (known as the *Come Out Roll*) is a 7 or an 11, he wins automatically. If a 2, 3, or 12 is rolled, he *craps out,* or loses. Any other number rolled (that is, 4, 5, 6, 8, 9, or 10) becomes the Pass Line *point.* Pass Line bets win if the shooter rolls the point before rolling a 7. If a 7 is rolled prior to the point being made, the shooter *sevens out* and the Pass Line bet loses, whereupon the dice are passed to the next player. A player need not be the shooter to make a Pass Line bet; however, the shooter must bet on either the Pass Line or Don't Pass Line.

Don't Pass Line (B). The Don't Pass Line bet is the opposite of the Pass Line bet; that is, the bet wins automatically on the Come Out Roll if a 2 or 3 is rolled and loses automatically if a 7 or an 11 is rolled. A roll of 12 is a standoff on the Don't Pass Line. Any other number rolled becomes the point. To win, a 7 must be rolled before the point is thrown. If the point is rolled prior to a 7, the bet loses. A Don't Pass bet may not be made *after* the Come Out Roll. A player need not be the shooter to make this bet.

Come (C). A player can "come" at any time after a point has been established on the Come Out Roll. The win-loss rules are the same as for the Pass Line. The next roll of the dice determines whether the player automatically wins, loses, or establishes the point that must be rolled before a 7 to win. The Come bet and point are independent of the Pass Line point.

Don't Come (D). The Don't Come bet may be made any time after a point has been established. The win-loss rules are the same as for the Don't Pass Line, but the automatic win, loss, or determination of the point is established by the next roll of the dice. Like the Come bet, the Don't Come bet allows a player to bet on each roll of the dice.


PASSLINE
NO CALL BETS
Don't Pass, Bar
Don't Come Bar
PLACE BETS
4
5
SIX
8
NINE
10
COME
Pays Double 2
3 • 4 • 9 • 10 • 11
Pays Double 12
FIELD
HARDWAYS
9 TO 1
7 TO 1
ONE ROLL BETS
4 TO 1 ANY SEVEN 4 TO 1
30 TO 1
15 TO 1
HORN BET
7 TO 1 ANY CRAPS 7 TO 1
A
B
C
D
E
F
G
H
J

Pass Line, Don't Pass Line, Come, and Don't Come bets are paid even money. Pass Line and Don't Pass Line bets may be made only on the Come Out Roll and may not be bet after the point is established. Don't Pass Line and Don't Come bets may be decreased or removed at any time, but they may never be increased or replaced.

Odds. A player may elect to make a wager in addition to the original, or *flat,* bet any time after the point is established. A player may *take* odds on any Pass Line or Come bet. A player may also *lay* odds on any Don't Pass or Don't Come bet. Typical odds payouts are shown on the table on the following page. The Odds bet wins if the flat bet wins and vice versa.

Buy and Lay bets. Buy and Lay bets pay odds without requiring a *flat* bet and may be made directly on a 4, 5, 6, 8, 9, or 10 at any time, without waiting for the number to roll the first time. These bets may be made on one or more of these numbers. The *Buy bet* is a bet that the specific number will roll before a 7; it is similar to the Pass Line bet. A *Lay bet* is a bet that a 7 will roll before the specific number; it is similar to the Don't Pass Line bet. In either case, the wager is paid according to true odds. A commission is usually charged on all Buy and Lay bets, either on the amount bet if it is a Buy bet or on the amount that can be won if it is a Lay bet.

Place bets to win. A Place bet to win is the same as a Buy bet except that the odds are different and no commission is charged. Refer to the table on the following page for Place bet odds.

All odds, Buy bets, and Place bets may be increased, decreased, taken back by the player, or called "off " at any time. Come odds, Buy bets, and Place bets to win are always off on the Come Out Roll unless designated otherwise by the player. Come odds, Don't Pass odds, Don't Come odds, Buy bets, and Place bets are all given to the dealer, who places them in the proper locations on the layout. Each player is responsible for placing Pass Line odds on the layout and keeping track of all bets paid, won, or lost.

Field (E). The Field bet is a one-roll bet that may be made on any roll. If a 2, 3, 4, 9, 10, 11, or 12 is rolled, the bet wins. All numbers pay even money, except 2 and 12, which usually pay double or triple. If any other numbers are rolled, the bet loses.

Big 6 or Big 8 (F). The bet wins if a 6 or an 8 is rolled before a 7. The wager pays even money (in some locations, if the wager is six dollars or a multiple of 6, the bet pays 7 to 6). The bet may be made on any roll.

Any 7 (G). If a 7 is rolled, the bet wins and pays 4 to 1. All other numbers lose.

Any craps (H). If a 2, 3, or 12 is rolled, the bet wins and pays 7 to 1. All other numbers lose.

Hardways (I). Hardways may be bet on any roll. The four possible Hardway bets are a Hard Six (two 3s) and a Hard Eight (two 4s), which pay 9 to 1, and a Hard Four (two 2s) and a Hard Ten (two 5s), which pay 7 to 1. The player wins if the Hardway he is betting rolls before a 7. The bet loses if a 7 is rolled first or if the number is rolled with a nonpair combination. For example, a Hard Six wins only if two 3s are thrown before a 7 or before an *Easy way* 5 and 1 or 4 and 2 combination. Hardways are always off unless the player designates the bet to be in action on the Come Out Roll.

Horn High bets (J). Horn High bets are typically bet in units of five since a player is effectively betting one unit each on 2, 3, 11, and 12, with one additional unit bet on the one number he designates. For example, a five-dollar Horn High 12 has one dollar bet on 2, 3, and 11 and two dollars bet on 12. If one of these four numbers is rolled, the payoff is according to the payout odds for that number of dollars effectively wagered on that number less the amount bet on the three losing numbers. The player may also bet on just one of the Horn bets. They are as follows:

TWO CRAPS OR ACES: If two "aces," or a 2, is rolled, the bet wins and pays 30 to 1.

TWELVE CRAPS: If a 12 is rolled, the bet wins and pays 30 to 1.

THREE CRAPS OR ACE-DEUCE: If "ace-deuce," or a 3, is rolled, the bet wins and pays 15 to 1.

ELEVEN: If an 11 is rolled, the bet wins and pays 15 to 1.

Craps Payout Odds

	Payout Odds		Payout Odds
Pass Line Bet	1 to 1	*Don't Pass Line Bet*	1 to 1
Come Bet	1 to 1	*Don't Come Bet*	1 to 1
Pass Line Odds, Come Bet Odds, and Buy Bets		*Don't Pass Line Lay Odds, Don't Come Lay Odds, and Lay Bets*	
• Points of 4 or 10	2 to 1	• Points of 4 or 10	1 to 2
• Points of 5 or 9	3 to 2	• Points of 5 or 9	2 to 3
• Points of 6 or 8	6 to 5	• Points of 6 to 8	5 to 6
Place Bet to Win		*Big Six or Big Eight*	1 to 1
• Points of 4 or 10	9 to 5		
• Points of 5 or 9	7 to 5		
• Points of 6 or 8	7 to 6		
		Hardways	
		• Hard 6 or Hard 8	9 to 1
		• Hard 4 or Hard 10	7 to 1

One-Roll Bets

	Payout Odds
Field Bets	1 to 1
• 3, 4, 9, 10, or 11	
• 2 or 12, 2 to 1	
Proposition Bets	
• Any 7	4 to 1
• Any Craps	7 to 1
• 2 or 12	30 to 1
• 3 or 11	15 to 1
Horn Bets	
• 2 or 12	30 to 1
• 3 or 11	15 to 1
Horn High Bets	
• 2 or 12	12 to 1
• 3 or 11	6 to 1

Blackjack, or Twenty-One

Method of Play

The object of blackjack (twenty-one) is to draw cards that total as close to 21 as possible without going over, while beating the dealer's hand. To begin the game, each player places his bet before being dealt any cards. The dealer then deals two cards to each player. He deals himself one card up and the other face down. When the total value of a hand is added up, the king, queen, and jack each count as 10. The ace counts as either one or eleven, and all other cards equal their face values.

If a player has an ace with a 10, jack, queen, or king, he has *blackjack*—a natural 21 total—and is paid 3 to 2 (three dollars paid for each two-dollar bet). If the dealer also has blackjack, it is called a *push,* and the player neither wins nor loses.

If the player does not have blackjack, the player may elect to *stand* (not accept any more cards) or be *hit* (accept more cards from the dealer to get closer to 21). The player may be hit with as many cards as he likes (one at a time), but if his card total exceeds 21, he has *busted* and the dealer collects his bet. When the player believes he is as close to 21 as he can get without going over, he stands.

When all players at the table have either busted or decided to stand, the dealer's facedown card is turned up. If the dealer's card count is 16 or less, he must draw cards to get closer to 21. If the dealer's card count is 17 or more, he cannot draw more cards except in some jurisdictions, where he may draw if he has a *soft* 17 (a hand that can be totaled either 7 or 17, for example, a 6 with an ace).

When the dealer has either busted or is standing on the total of his hand, he totals the cards of each player's hand. He pays off, at even money, bets of the players whose hands are closer to 21 than his, and he collects bets from those players whose hands are farther from 21 than his. If the dealer busts, he pays off, at even money, each player that hasn't busted. If a player's total is the same as the dealer's (and adds up to 21 or less), it is a push and he neither wins nor loses.

Special Terminology

Splitting pairs. If a player's first two cards are a pair, he may split them into two hands provided that the bet on the second hand equals his original bet. Once the hands are split and the wager placed, he plays the first hand and then he plays the second hand. If the split pair are aces, the player is limited to a one card draw on each hand.

Doubling down. If a player's first two cards total 10 or 11, he may elect to wager an additional amount that cannot exceed the value of the original bet. If the player doubles down, he draws only one additional card.

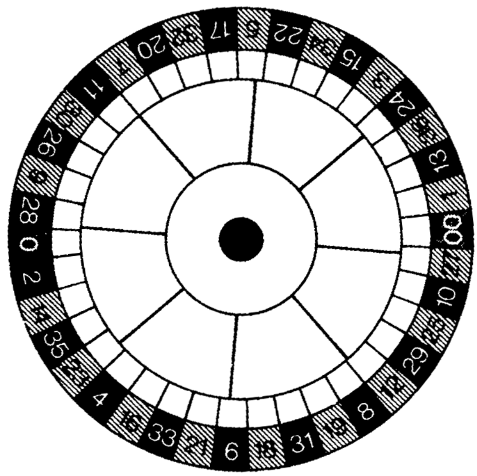
Insurance. If the dealer's up card is an ace, a player may elect to *take insurance* by placing, on the insurance line, a bet not greater than one-half of his original bet. The insurance bet is a wager that the dealer has blackjack. Insurance bets pay 2 to 1 if the dealer has blackjack, but they lose in all other instances. The dealer collects all losing insurance wagers before he deals additional cards.

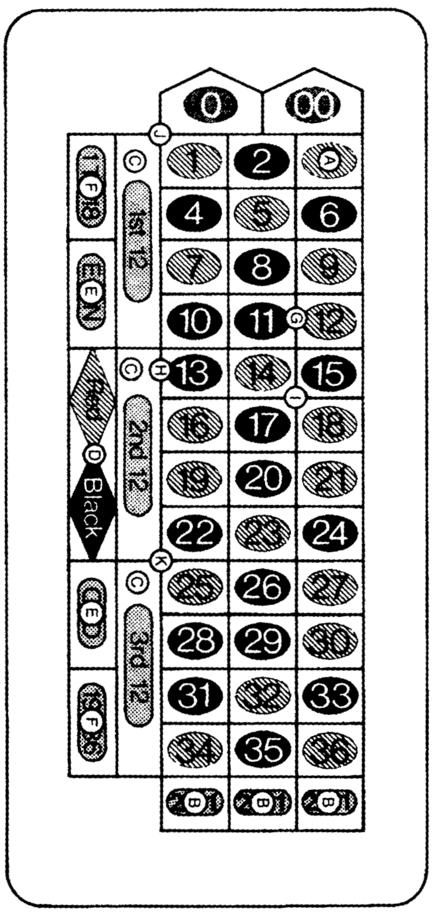
Surrender. After a player receives his first two cards, he may elect to surrender one-half of his wager along with his hand if he does not wish to continue to play the hand.

Roulette

A roulette wheel is numbered from 1 through 36 and also has 0 and 00 (although in some jurisdictions roulette may be played without a 00). The numbers are alternately colored red and black except 0 and 00, which are green. The roulette layout, located on the table next to the wheel, is numbered and colored in the same way as the wheel is.

Even-money bets (bets that pay 1 to 1) may be made on the colors red or black, odd or even numbers, and high or low numbers (the ranges of 1 to 18 or 19 to 36). Bets on just one number pay 35 to 1. In roulette a player may make bets covering more than one number. For example, a bet covering two numbers (called a *split bet*) pays 17 to 1. Bets are made by placing chips (usually nonvalue chips, that is, chips bearing no face value but having a value assigned when issued to the customer in exchange for cash or credit) on the desired number or color on the layout.




0
00
1st 12
2nd 12
3rd 12
Red
Black

The dealer spins the wheel and rolls a small white ball in the opposite direction. Bets may still be made after the wheel is spinning and up to the time that the dealer says, "No more bets." When the ball comes to rest, the dealer points out the winning number and winning bets are paid. The exact placement of the chip(s) determines each bet being made.

The positions of the bets are indicated in the foregoing illustration by corresponding letters. Examples of the payout odds are as follows:

Roulette Straight Bets

Example Position	Type of Bet	Pays Off If Ball Comes to Rest On	Odds
A	Straight Up	The individual number bet, including zero and double zero	35 to 1
B	Column	Any of the twelve numbers in the column bet	2 to 1
C	Dozen	Any number in the range 1 through 12, 13 through 24, or 25 through 36, depending on which dozen is bet	2 to 1
D	Red or Black	Any number of the same color that was bet	2 to 1
E	Odd or Even	Any odd number for odd bet, even number for even bet	1 to 1
F	1 to 18 or 19 to 36	Any number in the range bet	1 to 1

Roulette Combination Bets

Example Position	Type of Bet	Pays Off If Ball Comes to Rest On	Odds
G	Split	Either of the two numbers bet	17 to 1
H	Row	Any of the three numbers in the row bet	11 to 1
I	Corner	Any of the four numbers forming the corners	8 to 1
J	Five Numbers	0, 00, 1, 2, or 3	6 to 1
K	Six Numbers	Any of the six numbers in the two rows bet	5 to 1

Wheel of Fortune, or Big Six

The wheel has positions on it marked by bills in denominations from one dollar to twenty dollars. Two extra positions are marked with special symbols that indicate the largest payoffs. Adjacent to the wheel is a layout that represents the dollar denominations on the wheel.

To place a bet, a player puts the amount he wants to wager on a spot on the layout that corresponds to a denomination on the wheel. The larger the bill on which he wagers, the higher the odds. After all bets have been placed, the dealer spins the wheel. No bets can be placed after the wheel begins to spin.

The winning bets are paid after the wheel stops on a position indicated by the *flapper* at the top of the wheel. The payout odds are as follows:

A Bet On	Pays
$1	1 to 1
$2	2 to 1
$5	5 to 1
$10	10 to 1
$20	20 to 1
Joker	40 to 1
Flag	40 to 1

Baccarat

The object of baccarat is to obtain cards that total as close as possible to 9. All cards count as face values, that is, ace is counted as 1, deuce is 2, and so on. All 10s and face cards, or any combination of 10, have no value. For example, 9 + 5 = 4; 10 + 1 + 3 = 4.

To begin the game, two cards are dealt from a *shoe* to each of two hands, one of which is called *Player,* and the other, *Banker.* Customers may bet on either hand. If the point count of either hand is an 8 or 9, it is a *natural* and no cards are drawn.

If neither hand is a natural, the following rules are always observed:

- Player draws a third card when his first two cards total 0, 1, 2, 3, 4, or 5; he stands when his first two cards total 6 or 7.
- If Player's first two cards total 6 or 7 (and Player stands), Banker draws a third card when his first two cards total 0, 1, 2, 3, 4, or 5; he stands when his first two cards total 6 or 7.
- If Player draws a third card, Banker follows these rules:

Having	Draws When Player's Third Card Is:	Does Not Draw When Player's Third Card Is:
3	1, 2, 3, 4, 5, 6, 7, 9, 0	8
4	2, 3, 4, 5, 6, 7	1, 8, 9, 0
5	4, 5, 6, 7	1, 2, 3, 8, 9, 0
6	6, 7	1, 2, 3, 4, 5, 8, 9, 0
7	STANDS	

The only decision that a customer makes is what to bet on and how much to bet. If both hands end in equal totals, it is a tie and neither hand wins or loses. A separate tie bet pays 8 to 1. The house collects a 5-percent commission on all money won on Banker's side. These commissions are paid after the shoe has been dealt.

Mini baccarat has the same rules as baccarat but it is played on a smaller table. The table is approximately the size of a blackjack table and the layout is half of that on a baccarat table.

Coin[1]-operated Devices

Slot Machines

Slot machines are available in a variety of models and coin denominations. One or more coins may be played at one time, depending upon the model of slot machine the player chooses. The player begins by placing one or more coins in the machine, which allows the handle to be pulled. The pull of the handle starts a series of wheels spinning. Each wheel has a number of symbols or numbers on it. The appearance of certain symbols, the number of symbols, and the sequence of symbols determine the payout on each machine model. Winning combinations and the payout are depicted on visual displays on each machine. The frequency of payouts is random.

In multiple-coin machines, additional coins provide more opportunities to win with each handle pull or they provide larger payouts. For example, each additional coin in one type of machine provides another line to match up a winning combination of symbols. In a left-right-left machine, the winning sequence of symbols occurs either reading from the left to the right or from the right to the left. With another machine, each additional coin "buys" additional symbols. In yet another machine, the more coins a player puts into the machine, the greater the payout.

Some winning combinations are paid automatically by the machine, while others require a slot attendant to pay off the jackpot. A light on top of the machines signals a slot attendant when his assistance is necessary for a payout. Additional coins should not be played until the machine or the slot attendant has completed the payout.

Electronic Video Devices

Electronic video devices are coin-operated electronic simulations of other casino games, such as craps, poker, blackjack, and keno. The rules for the electronic games are typically the same as those for their casino counterparts.

Keno

A keno ticket is numbered from 1 through 80. These numbers correspond to eighty numbered Ping-Pong-like balls contained in a special holding unit. The player marks from one to fifteen numbers on the ticket and the amount of the wager. As the game begins, the balls are mixed in the holding unit, called a *squirrel cage,* and then, one at a time, they are "thrown" by the machine into another holder, called *rabbit ears.* Twenty balls go into the holder. A keno *writer* calls the winning numbers over a loudspeaker and lights up the corresponding numbers on displayed keno boards. Winning wagers are determined by how many numbers on the player's ticket match those lighted up on the boards. A keno *payout schedule* lists the number of matching numbers—catches—the player needs to make in order to win.

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[1] In this appendix the use of the word "coin" is defined to be money or its equivalent.

Appendix D

Statement of Position 98-5

Reporting on the Costs of Start-Up Activities

April 3, 1998

Issued by the Accounting Standards Executive Committee

NOTE

Statements of Position on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, identifies AICPA Statements of Position that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category *b* of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this Statement of Position if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the Statement of Position should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

TABLE OF CONTENTS

SUMMARY

This Statement of Position (SOP) provides guidance on the financial reporting of start-up costs and organization costs. It requires costs of start-up activities and organization costs to be expensed as incurred.

The SOP broadly defines start-up activities and provides examples to help entities determine what costs are and are not within the scope of this SOP.

This SOP applies to all nongovernmental entities and, except as stated in the last paragraph, is effective for financial statements for fiscal years beginning after December 15, 1998. Earlier application is encouraged in fiscal years for which annual financial statements previously have not been issued.

Except for certain entities noted in the last paragraph, initial application of this SOP should be reported as the cumulative effect of a change in accounting principle, as described in Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*.[*] When adopting this SOP, entities are *not* required to report the pro forma effects of retroactive application.

Entities that report substantially all investments at market value or fair value, issue and redeem shares, units, or ownership interests at net asset value, and have sold their shares, units, or ownership interests to independent third parties before the later of June 30, 1998, or the date that the SOP is issued should adopt the SOP prospectively.

[*] See footnote * in the Transition section of the Audit and Accounting Guide *Construction Contractors* for information on the exposure draft of a proposed FASB statement which would supersede APB Opinion No. 20. [Footnote added, May 2005, to reflect the 2005 conforming changes made to the Audit and Accounting Guide *Construction Contractors*.]

FOREWORD

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSECs fifteen members, and (3) a proposed final document that has been approved by at least ten of AcSECs fifteen members. The document is cleared if at least five of the seven FASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in their review of proposed projects and proposed documents include the following.

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.
2. The proposal will result in an improvement in practice.
3. The AICPA demonstrates the need for the proposal.
4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, prior to clearance, the FASB will propose suggestions, many of which are included in the documents.

Introduction and Background

1. The Accounting Standards Executive Committee (AcSEC) had on its agenda a series of projects on reporting the costs of activities that are undertaken to create future economic benefits.

2. The first phase of AcSECs series of projects resulted in its issuance of Statement of Position (SOP) 93-7, *Reporting on Advertising Costs*. It was AcSEC's intention to use SOP 93-7 as a guide in developing guidance for reporting costs of other kinds of activities undertaken to create future economic benefits. This SOP on start-up costs is the next phase.

3. A review of a number of public-company financial statement disclosures indicates that some entities capitalize start-up costs whereas others expense start-up costs as they are incurred. In addition, entities that capitalize start-up costs use diverse amortization periods. These diverse practices exist within and across industries. AcSEC believes this SOP will significantly reduce these diversities in financial reporting.

4. AcSEC issued an exposure draft of a proposed SOP, *Reporting on the Costs of Start-Up Activities*, on April 22, 1997. AcSEC received more than eighty comment letters in response to the exposure draft.

Scope

5. For purposes of this SOP, start-up activities are defined broadly as those one-time activities related to opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer[1] or beneficiary, initiating a new process in an existing facility, or commencing some new operation. Start-up activities include activities related to organizing a new entity (commonly referred to as organization costs). This SOP provides guidance on accounting for the costs of start-up activities.

6. In practice, various terms are used to refer to start-up costs, such as *preopening costs*, *preoperating costs*, *organization costs* and *start-up costs*. For purposes of this SOP, these costs are referred to as start-up costs.

> *Note: As noted in subsequent paragraphs, the accounting for certain costs incurred in conjunction with start-up activities are not covered by this SOP. An entity should not infer that costs outside the scope of this SOP should be capitalized. Such costs should not be capitalized unless they qualify for capitalization under other generally accepted accounting principles.*

7. For purposes of this SOP, activities related to routine, ongoing efforts to refine, enrich, or otherwise improve upon the qualities of an existing product, service, process,[2] or facility are not start-up activities and are not within the

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[1] This SOP does not address the financial reporting of costs incurred related to ongoing customer acquisition, such as policy acquisition costs in Financial Accounting Standards Board (FASB) Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* and loan origination costs in FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. The SOP addresses the more substantive one-time efforts to establish business with an entirely new class of customers (for example, a manufacturer who does all of its business with retailers attempts to sell merchandise directly to the public).

[2] Costs addressed in Emerging Issues Task Force Issue No. 97-13, *Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation*, are outside the scope of this SOP.

scope of this SOP. In addition, activities related to a merger or acquisition and to ongoing customer acquisition[3] are not start-up activities.

8. Certain costs that may be incurred in conjunction with start-up activities are not subject to the provisions of this SOP. Such costs should be accounted for in accordance with other existing authoritative accounting literature. For example, the following costs are outside the scope of this SOP:

- Costs of acquiring or constructing long-lived assets and getting them ready for their intended uses (However, the costs of using long-lived assets that are allocated to start-up activities [for example, depreciation of computers] are within the scope of this SOP.)
- Costs of acquiring or producing inventory
- Costs of acquiring intangible assets (However, the costs of using intangible assets that are allocated to start-up activities [for example, amortization of a purchased patent] are within the scope of this SOP.)
- Costs related to internally developed assets (for example, internal-use computer software costs) (However, the costs of using those assets that are allocated to start-up activities are within the scope of this SOP.)
- Costs that are within the scope of Financial Accounting Standards Board (FASB) Statement No. 2, *Accounting for Research and Development Costs*, and FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*
- Costs of fund raising incurred by not-for-profit organizations
- Costs of raising capital
- Costs of advertising
- Costs incurred in connection with existing contracts as stated in paragraph 75*d* of SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

9. Illustrations 1 through 3 in the Appendix provide examples of costs that are and are not within the scope of this SOP.

10. This SOP applies to all nongovernmental entities (including not-for-profit organizations) and it applies to development-stage entities as well as established operating entities.

11. This SOP amends the following AICPA SOPs and Audit and Accounting Guides that address start-up costs:

a. SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, paragraph 75*a*

b. SOP 88-1, *Accounting for Developmental and Preoperating Costs, Purchases and Exchanges of Take-off and Landing Slots, and Airframe Modifications*, paragraphs 23 and 25

c. Industry Audit Guide *Audits of Airlines*, paragraphs 3.115 and 3.117

d. Audit and Accounting Guide *Audits of Casinos*, paragraph 2.06

e. Audit and Accounting Guide *Construction Contractors*, paragraph 2.14*a*

[3] See footnote 1.

f. Audit and Accounting Guide *Audits of Federal Government Contractors*, paragraph 3.09

g. Audit and Accounting Guide *Audits of Investment Companies*, paragraphs 5.14, 8.10, 8.16, 8.17, and Appendix K

Conclusions

Accounting for Start-Up Costs

12. Costs of start-up activities, including organization costs, should be expensed as incurred.

Amendments to Other Guidance

13. This SOP amends SOP 81-1 by requiring precontract costs that are start-up costs to be expensed as incurred. The following sentence is added to the end of paragraph 75*a*:

> Those costs should be expensed as they are incurred if they are within the scope of SOP 98-5, *Reporting on the Costs of Start-Up Activities*.

14. This SOP amends SOP 88-1 by requiring preoperating costs to be expensed as incurred rather than capitalized. Paragraph 23 is amended as follows:

> Preoperating costs related to the integration of new types of aircraft should be expensed as incurred.

In addition, paragraph 25 is deleted.

15. This SOP amends the Industry Audit Guide *Audits of Airlines* by requiring preoperating costs to be expensed as incurred rather than capitalized. Paragraph 3.115 is amended as follows:

> Preoperating costs related to the integration of new types of aircraft should be expensed as incurred.

In addition, paragraph 3.117 is deleted.

16. This SOP amends the Audit and Accounting Guide *Audits of Casinos* by requiring preopening costs to be expensed as incurred. Paragraph 2.06 is amended to include the following at the end of the first sentence:

> Preopening costs, however, should be charged to expense as incurred.

17. This SOP amends the Audit and Accounting Guide *Construction Contractors* by requiring precontract costs that are start-up costs to be expensed as incurred. The following sentence is added to the end of paragraph 2.14*a*:

> Those costs should be expensed as they are incurred if they are within the scope of SOP 98-5, *Reporting on the Costs of Start-Up Activities*.

18. Paragraph 3.09 of the Audit and Accounting Guide *Audits of Federal Government Contractors* refers to paragraph 75 of SOP 81-1 as the applicable guidance for accounting for precontract costs. This SOP amends paragraph 3.09 of the Guide as follows:

> Precontract costs should be accounted for in conformity with paragraph 75 of SOP 81-1, as amended by SOP 98-5, *Reporting on the Costs of Start-Up Activities*.

19. This SOP amends the Audit and Accounting Guide *Audits of Investment Companies* by requiring organization costs to be expensed as they are incurred. The last two sentences of paragraph 8.10 are deleted and replaced by the following:

> Organization costs should be expensed as they are incurred. Entities should adopt the transition provisions of paragraphs 22 and 23 of SOP 98-5, *Reporting on the Costs of Start-Up Activities*.

In addition, paragraphs 8.16 and 8.17 are deleted, and the following footnote is added after the words *deferred organization expense* in paragraph 5.14 and in the Statement of Assets and Liabilities in Appendix K (SOP 93-4, *Foreign Currency Accounting and Financial Statement Presentation for Investment Companies*).

> Organization costs should be expensed as they are incurred. Entities should adopt the transition provisions of paragraphs 22 and 23 of SOP 98-5, *Reporting on the Costs of Start-Up Activities*.

20. The following sentence is added to the accounting policies footnote for organization costs in the illustrative financial statements in paragraph 9.10 of the Audit and Accounting Guide *Guide for Prospective Financial Information*:

> (Note: SOP 98-5, *Reporting on the Costs of Start-Up Activities*, requires that organization costs be expensed as they are incurred.)

Effective Date and Transition

21. Except for certain entities noted in paragraph 23, this SOP is effective for financial statements for fiscal years beginning after December 15, 1998. Earlier application is encouraged in fiscal years for which annual financial statements have not been issued. Restatement of previously issued financial statements is not permitted.

22. Except for certain entities noted in paragraph 23, initial application of this SOP should be reported as the cumulative effect of a change in accounting principle, as described in Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*.[*] When adopting this SOP, entities are *not* required to report the pro forma effects of retroactive application. Entities are required to disclose the effect of adopting this SOP on income before extraordinary items and on net income (and on the related per share amounts) in the period of the change.

23. Entities that meet all of the following conditions should not report the effect of initial application of this SOP as a cumulative effect of a change in accounting principle: (*a*) the entities' specialized accounting practices include accounting for substantially all investments at market value or fair value; (*b*) the entities' shares, units, or ownership interests are issued and redeemed at net asset value; and (*c*) the entities' shares, units, or ownership interests are sold to independent third parties (for example, parties other than founders, sponsors, and investment advisors) before the later of June 30, 1998, or the date that the SOP is issued. Capitalized costs incurred by these entities prior to initial application of this SOP should not be adjusted to the amounts that would have been expensed as incurred had this SOP been in effect when those costs were incurred. These entities should apply the SOP prospectively for all

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[*] See footnote * in Summary.

costs of start-up activities and organization costs incurred at the later of June 30, 1998, or the date that the SOP is issued. For these entities, costs previously deferred that continue to be reported as assets should continue to be amortized over the remaining life of the original amortization period used by the entity, or a shorter period if the expected period of benefit is reduced. The unamortized balance of deferred start-up costs or organization costs and the remaining amortization period should be disclosed.

24. Except for those entities noted in paragraph 23, initial application of this SOP should be as of the beginning of the fiscal year in which the SOP is first adopted.

The provisions of this Statement need not be applied to immaterial items.

Basis for Conclusions

Scope

25. AcSEC based its broad definition of start-up activities on the definition used in the 1973 FASB Discussion Memorandum (DM), *Accounting for Research and Development Costs*. That DM defines start-up costs as "those unusual one-time costs incurred in putting a new plant into operation, opening a new sales outlet, initiating a new process in an existing plant, or otherwise commencing some new operation."

26. Some respondents to the exposure draft indicated that the definition of start-up activities is imprecise and leads to confusion about what differentiates start-up costs from certain other costs, such as costs incurred to get a long-lived asset ready for its intended use.

27. AcSEC believes it is not possible to develop a detailed, all-inclusive definition of start-up activities and start-up costs. AcSEC believes the broad definition of start-up activities together with the identification of certain costs that are not start-up costs and the examples provided in the Appendix help the reader understand the kinds of activities and costs that may be involved in a start-up situation. Regardless, AcSEC believes that costs previously capitalized as either start-up costs or organization costs should now be expensed as they are incurred.

28. AcSEC understands that entities may engage in start-up activities to generate revenue or increase efficiencies; AcSEC believes that it is unnecessary to distinguish between the objectives for undertaking start-up activities for purposes of this SOP.

29. AcSEC recognizes that some entities use the terms *start-up*, *preopening*, *preoperating*, and *organization* interchangeably and that these terms are used inconsistently in practice. AcSEC believes that it is unnecessary to define the terms individually for purposes of this SOP.

30. AcSEC also recognizes that some entities differentiate between preopening/preoperating costs and start-up costs as follows:

a. Preopening/preoperating costs are incurred before the commencement of operations or production.

b. Start-up costs are incurred after operations have begun, but before normal productive capacity is reached.

AcSEC believes that this distinction is not made consistently in practice. AcSEC also believes that the guidance in this SOP should be followed regardless of the terms used to describe the activities included in the scope.

31. AcSEC decided that it was not necessary to develop boundaries for when the start-up period begins and ends. The definition of start-up activities is based on the nature of the activities and not the time period in which they occur. AcSEC believes that costs previously capitalized by entities as start-up costs will be expensed as incurred as start-up costs or some other costs, such as general and administrative.

32. It is not uncommon for start-up activities to occur simultaneously with other activities, such as the acquisition or development of assets. Paragraph 8 provides examples of costs excluded from the scope of this SOP. AcSEC did not attempt to provide an all-inclusive detailed list of such costs because entities have different accounting policies for the kinds of costs capitalized under existing generally accepted accounting principles (for example, property, plant, and equipment). AcSEC believes entities are best capable of identifying those costs.

33. This SOP applies to start-up activities of development stage entities as well as established operating entities, as those terms are discussed in FASB Statement No. 7, *Accounting and Reporting by Development Stage Enterprises*. Paragraph 10 of FASB Statement No. 7 states, "Generally accepted accounting principles that apply to established operating enterprises shall govern the recognition of revenue by a development stage enterprise and shall determine whether a cost incurred by a development stage enterprise is to be charged to expense when incurred or is to be capitalized or deferred." This SOP sets forth the generally accepted accounting principles for costs of start-up activities and thus applies to both kinds of entities.

34. A majority of respondents to the exposure draft did not address issues related to organization costs. The majority of those who did address these issues believes that organization costs should not be included in the scope of the SOP. One reason proposed to exclude organization costs from the scope of this SOP was to avoid unnecessary bookkeeping resulting from book/tax differences. AcSEC concluded that organization costs are similar to start-up costs and that it could not justify excluding organization costs from the scope of the SOP. Further, if organization costs were excluded from the scope of the SOP, AcSEC believes that it would have needed to define organization costs to help entities distinguish between start-up and organization costs. AcSEC's definition of organization costs would have been narrower than that contained in the Internal Revenue Code. Therefore, AcSEC concluded that temporary tax differences would result for some entities whether AcSEC included or excluded organization costs from the scope of the document.

Accounting for Start-Up Costs

35. About half of the respondents to the exposure draft believe that start-up costs should be reported as assets. AcSEC considered requiring capitalization and amortization of the costs of start-up activities, including organization costs. AcSEC believes that entities incur costs related to start-up and organization activities with an expectation that there will be future benefits. However, AcSEC believes that this is also often the case with other costs, such as costs related to research and development activities.

36. Paragraph 86 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, states, "Consumption of economic benefits during a period may be recognized either directly or by relating it to revenues recognized during the period: . . ." Paragraph 148 of FASB Concepts Statement No. 6, *Elements of Financial Statements*, states, Other costs are also recognized as expenses in the period in which they are incurred because the period to which they otherwise relate is indeterminable or not worth the effort to determine.

37. Some AcSEC members believe that start-up costs may meet the definition of an asset. However, they note that some items that meet the definition of an asset are not recognized as assets because of uncertainty. Paragraph 175 of FASB Concepts Statement No. 6 states, "... business enterprises engage in research and development activities, advertise, develop markets, open new branches or divisions, and the like, and spend significant funds to do so. The uncertainty is not about the intent to increase future economic benefits but about whether and, if so, to what extent they succeeded in doing so. Certain expenditures for research and development, advertising, training, start-up and preoperating activities, development stage enterprises, relocation or rearrangement, and goodwill are examples of the kinds of items for which assessments of future economic benefits may be especially uncertain."

38. Paragraph 24 of APB Opinion 17 states, "Costs of developing, maintaining, or restoring intangible assets which are not specifically identifiable, have indeterminate lives, or are inherent in a continuing business and related to an enterprise as a whole, such as goodwill, should be deducted from income when incurred." Start-up costs as defined in this SOP meet all three conditions: they are not specifically identifiable, have indeterminate lives, and are inherent in a continuing business and related to an enterprise as a whole.

39. AcSEC decided that the SOP should not amend paragraph 75d of SOP 81-1. AcSEC believes that start-up costs incurred in connection with existing contracts are contract costs related to a specific source of revenue that should be subject to the accounting prescribed in SOP 81-1. Further, AcSEC decided that start-up costs incurred in connection with existing contracts *and* in anticipation of follow-on or future contracts for the same goods and services should also be accounted for as contract costs within the existing contract because those costs are expected to be recovered. AcSEC also believes that it is impracticable to bifurcate incremental learning curve or start-up costs that may be incurred under existing contracts in anticipation of follow-on or future contracts.

Disclosure and Transition

40. AcSEC considered requiring entities to disclose start-up costs incurred in an accounting period and total start-up costs expected to be incurred over the life of a project. AcSEC decided that, for many entities, the costs of record-keeping to identify separately start-up costs incurred in an accounting period likely would outweigh the related benefits of disclosing those costs to users of financial statements. AcSEC also believes that it cannot provide an all-inclusive definition of start-up costs, which would ensure comparability between entities. In addition, AcSEC believes that, if an entity discloses total start-up costs expected to be incurred, it is likely to do so outside the financial statements (for example, in Management's Discussion and Analysis for a public company).

41. Some entities currently report certain costs, such as depreciation incurred in conjunction with start-up activities, as start-up costs. Other entities currently report those costs under captions such as "depreciation." This SOP does not require entities to report those costs as start-up costs.

42. AcSEC decided that entities that report substantially all investments at market value or fair value, issue and redeem shares, units, or ownership interests at net asset value, and have sold their shares, units, or ownership interests to independent third parties before the later of June 30, 1998, or the date that the SOP is issued should adopt the SOP prospectively. Examples of such entities include open-end mutual funds, regardless of their load features, because open-end mutual funds issue and redeem shares at net asset value (however, closed-end funds would not be examples because those funds may trade at a premium or discount in relation to net asset value). Before operations begin, these entities often incur start-up or organization costs. The expectation is that all shareholders will bear the costs as amortization gradually decreases asset value. Alternatively, the sponsors could pay the start-up or organization costs and get reimbursed through fees charged to the entity that would be borne by the shareholders. AcSEC believes that existing shareholders would experience negative economic consequences if previously capitalized costs were required to be expensed immediately, thereby causing an immediate decrease in net asset value per share. AcSEC believes that it has made a practical decision to ensure that the adoption of the SOP does not cause economic harm to existing shareholders in entities that report substantially all investments at market value or fair value and issue and redeem shares, units, or ownership interests at net asset value.

Other Authoritative Literature

43. AcSEC considered the following other authoritative literature in its deliberations of financial reporting of start-up costs. However, the guidance in the following literature is *not* affected by the provisions of this SOP: (*a*) FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, and the related AICPA Audit and Accounting Guide *Audits of Entities With Oil and Gas Producing Activities*; (*b*) FASB Statement No. 34, *Capitalization of Interest Cost*; (*c*) FASB Statement No. 50, *Financial Reporting in the Record and Music Industry*; (*d*) FASB Statement No. 51, *Financial Reporting by Cable Television Companies*; (*e*) FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*; (*f*) FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*; (*g*) FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*; and (*h*) FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*.

APPENDIX

Illustrations

The Illustrations provide examples that should not be interpreted to be all-inclusive. Accounting for certain costs incurred in conjunction with start-up activities are not covered by this SOP. An entity should not infer that costs outside the scope of this SOP should be capitalized. Such costs should not be capitalized unless they qualify for capitalization under other generally accepted accounting principles.

Illustration 1

Scenario—A major U.S. beverage company (the Company) begins construction of a new plant in China. This represents the Company's initial entry into the Chinese market. As part of the overall strategy, the Company plans to introduce into China, on a locally produced basis, the Company's major U.S. beverage brands. Following are some of the costs that might be incurred in conjunction with start-up activities that are subject to the provisions of this SOP:

- Travel costs, employee salary-related costs, and consulting costs related to feasibility studies, accounting, legal, tax, and governmental affairs
- Training of local employees related to production, maintenance, computer systems, engineering, finance, and operations
- Recruiting, organization, and training related to establishing a distribution network
- Nonrecurring operating losses
- Depreciation, if any, of new computer data terminals and other communication devices

The following costs incurred in conjunction with start-up activities are outside the scope of this SOP (as noted in paragraphs 7 and 8):

- Costs of long-lived asset additions, such as the new plant, production equipment, and packaging lines
- Internal-use computer software systems development costs
- Costs that are capitalizable as inventory
- Deferred financing costs

Illustration 2

Scenario—A retail chain is constructing and opening two new stores. One will open in a territory in which the entity already has three stores operating. The other will open in a territory new to the entity. (Costs related to both openings are treated the same for purposes of this SOP.) All of the stores provide the same products and services. Following are some of the costs that might be incurred in conjunction with start-up activities that are subject to the provisions of this SOP:

- Salary-related expenses for new employees
- Salary-related expenses for the management store opening team
- Training costs and meals for newly hired employees
- Hotel charges, meals, and transportation for the opening team
- Security, property taxes, insurance, and utilities costs incurred after construction is completed
- Depreciation, if any, of new computer data terminals and other communication devices
- Nonrecurring operating losses

The following costs incurred in conjunction with start-up activities are outside the scope of this SOP (as noted in paragraphs 7 and 8):

- Store advertising costs
- Coupon giveaways
- Costs of uniforms
- Costs of furniture and cash registers
- Costs to obtain licenses, if any
- Security, property taxes, insurance, and utilities costs related to construction activities
- Deferred financing costs

Illustration 3

Scenario—A not-for-profit organization that has provided meals to the homeless is opening a shelter to house the homeless. The organization will rent the facility. This will be the organization's first shelter and it will conduct a fund-raising campaign to raise money to start up the shelter. The organization will lease space for the shelter and will incur capital expenditures for leasehold improvements and furniture. The organization expects that it will require three months to set up the space for the shelter. The organization will hire a security firm to secure the premises during the three-month period in which the shelter is built. Following are some of the costs that might be incurred in conjunction with start-up activities that are subject to the provisions of this SOP:

- Employee salary-related costs related to needs and feasibility studies
- Staff recruiting and training
- Rent, security, insurance, and utilities
- Consultant fees for developing policies and procedures for operating the shelter
- Amortization and depreciation, if any, of leasehold improvements and furniture
- Costs of social workers

The following costs incurred in conjunction with start-up activities are outside the scope of this SOP (as noted in paragraphs 7 and 8):

- Costs of fund-raising
- Costs of leasehold improvements and furniture
- Architect fees for the leasehold improvements
- Advertising costs to publicize the shelter

Appendix E

Information Sources

Further information on matters addressed in this Guide is available through various publications and services listed in the table that follows. Many non-government and some government publications and services involve a charge or membership requirement.

Fax services allow users to follow voice cues and request that selected documents be sent by fax machine. Some fax services require the user to call from the handset of the fax machine, others allow the user to call from any phone. Most fax services offer an index document, which lists titles and other information describing available documents.

Recorded announcements allow users to listen to announcements about a variety of recent or scheduled actions or meetings.

All telephone numbers listed are voice lines, unless otherwise designated as fax (f) lines.

Information Sources

Organization	General Information	Fax Services	Internet Web Site	Recorded Announcements
American Institute of Certified Public Accountants (AICPA)	Harborside Financial Center 201 Plaza Three Jersey City, NJ 07311-3881 (888) 777-7077 Information about AICPA continuing professional education programs is available through the AICPA CPE Division (888) 777-7077 or (888) 247-3277 and the AICPA Meetings and Travel Division, (201) 938-3232	*Order Department* *24 Hour Fax Hotline* (201) 938-3787	www.aicpa.org www.cpa2biz.com	
Financial Accounting Standards Board (FASB)	*Order Department* P.O. Box 5116 Norwalk, CT 06856-5116 (203) 847-0700, ext. 10 800-738-0659		www.fasb.org	*Action Alert Telephone Line* (203) 847-0700 (ext. 444)
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Public Company Accounting Oversight Board (PCAOB)	A private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports		www.pcaobus.org/	

Organization	General Information	Fax Services	Internet Web Site	Recorded Announcements
Financial Crimes Enforcement Network United States Department of the Treasury	Support law enforcement investigative efforts and foster interagency and global cooperation against domestic and international financial crimes; and to provide U.S. policymakers with strategic analyses of domestic and worldwide money laundering developments, trends and patterns		www.fincen.gov/	
American Gaming Association	555 13th Street NW Suite 1010 East Washington, D.C. 20004	(202) 637-6500	www.americangaming.org	
Casino Management Association	3690 South Eastern Ave., Suite 213 Las Vegas, NV 89109-3377 (702) 895-9133	(702) 837-5353	www.cmaweb.org	
Casino Journal Publishing Group	8025 Blackhorse Pike Pleasantville, NJ 08232 (800) 969-0711	(609) 645-1661	www.casinocenter.com	

Appendix F

Glossary

The following is a list of terms, and a brief definition of each, used in the casino industry. These terms may differ among casinos.

accountability. All items of currency, chips, coins, tokens, receivables, and customer deposits constituting the total amount for which the bankroll custodian is responsible at a given time.

award schedule card. *See* payout schedule.

bank (bankroll). The inventory of currency, coins, and chips in the casino cage, pit area, and slot booths and on the playing tables. Used to make change, pay winning bets, and pay slot machine jackpots. *See also* casino bankroll, casino cage, slot booth, slot machine load, and table inventory.

base jackpot. The fixed, minimum amount of a slot machine payout for a specific combination.

betting ticket. A printed, serially numbered form used to record the event upon which a wager is made, the amount and date of the wager, and sometimes the line or spread (odds). Used to record bets on sporting and racing events.

bill validator. Will analyze the legitimacy of currency as it is inserted to ensure the currency is not counterfeit. *See also* currency acceptor.

bingo. A game using the draw of numbered balls for results. The player uses a card with five rows of five numbered squares, with the middle square blank.

blower. A device used in a keno or bingo game to mix the numbered balls and blow them individually into a receptacle when drawn.

booth cashier. An employee who is the custodian of a slot booth fund.

boxperson. The first-level supervisor who is responsible for directly participating in and supervising the operation and conduct of the craps game.

buy-in. The amount of money a player must present for coins and chips in a poker or pan (panguingui) game. Usually put in a separate drop box by the dealer. *See also* time buy-in.

cage credit. Advances in the form of cash or gaming chips made to customers at the casino cage. Documented by the players signing an IOU or a marker similar to a counter check.

calibration module. The section of a weigh scale used to set the scale to a specific amount or number of coins to be counted. *See also* weigh count.

caller. The person who calls numbers as they are drawn in bingo or keno.

cash count sheet. The form used to record the contents of the bankroll as they are counted.

cash loads. The initial currency, coins, chips, and so on issued from a bankroll to a gaming table or a coin-operated gaming device.

cashier's count sheet (checkout sheet). An itemized list of the components that make up the cage accountability.

cashier's count sheet reconciliation. A detailed reconciliation of the beginning and ending cage accountability.

cashless wagering system (ticket acceptor). A computer network interfaced with games enabling wagering to take place with wagering vouchers and coupons, or electronic wagering credits transferred to the games, only after the validity and value of the wagering instruments and credits have been confirmed by the system.

casino bankroll. The working fund of cash and gaming chips. Also serves as a depository control for gaming credit instruments.

casino cage. A secure work area within the casino for cashiers and a storage area for the casino bankroll.

casino cage cashier. The custodian of the casino bankroll. In some casinos it may refer to the person in charge of the central banking function.

casino host. An executive in the casino who is responsible for having knowledge of the financial condition of important customers, including their gambling history and their payment reliability. Is usually responsible for expediting credit play for the better customers as well as arranging for complimentary services for such customers.

casino manager. The executive who has the authority and responsibility for all gaming operations.

Central Credit. A private information service that maintains credit information supplied by casinos.

change person. A person who has an imprest fund of coins and currency for making change for slot customers.

check credit slip. A document that shows the total amount of a check accepted by the casino in return for credit to be issued to the customer. Usually a part of a counter check.

check jacket. An envelope used to hold a returned check, a hold check, or a marker pending collection. Usually contains copies of correspondence and evidence of other collection efforts.

checkout sheets. *See* cashier's count sheet.

checks. Slang for chips.

chip float. The dollar value of chips held by customers.

chips. Money substitutes, in various denominations, issued by a gaming establishment and used for wagering.

closer. The original form on which a table inventory is recorded at the end of a shift.

coin-operated gaming device. Any of a variety of mechanical or electronic apparatus used in connection with gaming. Includes slot machines and electronic video games such as poker, blackjack, craps, and keno.

complementaries (comps). Promotional allowances to customers.

count. The total funds counted for a particular game, coin-operated gaming device, shift, or other period.

counter check. A form provided by the casino for the customer to use in lieu of a personal check.

credit limit. The maximum dollar amount of credit assigned to a customer by the casino.

credit manager. The executive responsible for implementing the credit policies of a casino.

credit play. The wagering of chips obtained in exchange for a credit instrument (marker, IOU, and so on).

credit play memorandum (serialized record, rim card, table card, master card). A form to record the date, time, shift, game, table, amount of credit given, and the signatures or initials of the individuals extending the credit.

credit slip. A form used to record either (1) the return of chips from a gaming table to the casino cage or (2) the transfer of IOUs, markers, or negotiable checks from a gaming table to a casino cage or bankroll.

cross fill. The transfer of cash or chips from one gaming table to another or an even-money transfer. (Usually prohibited by regulatory agencies.)

croupier. *See* dealer.

currency acceptor. An electro-mechanical device contained in a slot machine that accepts paper currency, vouchers, or coupons in exchange for wagering credits.

customer deposits. The amounts placed with a casino cage cashier by customers for the customers' use at a future time.

daily pit summary sheet. A log retained in the pit that reflects the amount of chips received from and transferred to the cage.

dealer. An employee who conducts a game in a casino. Includes stickpersons and croupiers.

deskperson. An employee who authorizes payment on winning tickets and verifies payouts in keno.

discard tray. A tray, box, or specific area where cards used in a game are held until shuffled. Used primarily in baccarat and blackjack.

draw ticket. A blank keno ticket whose numbers are punched out when balls are drawn for the game. Used to verify winning tickets.

drop.

1. In table games, the total amount of cash and chips contained in the drop box, plus the amount of credit issued at the table.
2. In slots, the total amount of money removed from the drop bucket.

drop box. A locked container affixed to the gaming table into which the drop is placed. The game type, table number, and shift are indicated on the box.

drop bucket. A container located beneath a coin-operated gaming device for the purpose of collecting coins and tokens from the device.

drop count card. A document prepared by the count team to record the amount of cash, by denomination, in a drop box.

eye in the sky. An overhead surveillance area used to monitor gaming activity on the casino floor.

false drop. The amount of cash or cash equivalents used to purchase chips at a gaming table at which the customer does not play.

fill. A transaction whereby a supply of chips or coins and tokens is transferred from a bankroll to a table or a coin-operated gaming device.

fill slip. A document evidencing a fill.

floorperson.

1. In craps, the second-level supervisor responsible for the operation and conduct of a game.
2. In other games, the first-level supervisor responsible for the operation and conduct of a game.
3. In slots, the supervisor who approves jackpots and observes floor activity.

foreign chips. Chips that are redeemed for money or house chips by other than the issuing casino.

front money. A customer deposit that is used in lieu of credit to guarantee payment of a marker issued.

game bankroll (table bankroll). The inventory of gaming chips stored in the chip tray for each table game. Game bankrolls may be under the control of the casino bankroll or under separate general ledger controls. Table credit instruments are included in the game bankroll until they are transferred to the cage.

game count sheet. *See* master game report.

gross gaming revenue (win). The net win from gaming activities, which is the difference between gaming wins and losses before deducting costs and expenses.

handle. The total amount wagered.

hard count. The count of the contents in a drop bucket.

hold. *See* gross gaming revenue.

hold check. A check that is held in the custody of the casino and that has not been deposited at the request of the issuing customer.

hold percentage (PC). The relationship of hold to drop or handle.

hopper (payout reserve container). The tubes that contain the coins or tokens used to make payouts in a coin-operated gaming device.

hopper fill slip. A document used to record the monetary value of coins or tokens put into a hopper.

house. A casino.

inside ticket. A keno ticket retained by the house, showing the customers' selection of numbers and the amount wagered.

IOU. *See* marker.

issue slip. A copy of a credit instrument that is retained for numerical sequence control purposes.

jackpot payout. The portion of a jackpot paid by slot personnel. The amount is usually determined as the difference between the total posted jackpot amount and the coins paid out by the machine. May also be the total amount of the jackpot.

jackpot payout slip. A form on which the portion of a jackpot paid by slot personnel is recorded.

junket. An arrangement whose primary purpose is to induce a group to travel to a casino to gamble. Frequently the transportation, food, and lodging are paid directly or indirectly by the establishment.

junket representative. The person primarily responsible for organizing a junket.

junketeer. An individual participant in a junket.

keno runner. An employee who, as a convenience for customers in the casino and restaurant areas, collects keno tickets and remits winnings to customers.

key control ledger. A ledger that authorized personnel sign to receive keys to sensitive areas, such as drop boxes, safe deposit boxes, count room, and cashier's cage.

lammer button (marker button). A type of chip that is placed on a gaming table to indicate that the amount of chips designated thereon has been given to the customer for wagering on credit prior to completion of the credit instrument.

layoff. A wager by one race or sports book with another to offset an excessive accumulation of customer wagers on a particular race or event.

layout. In games like roulette or craps, a diagram on a gaming table, usually on felt, with spaces for bets.

limit. The minimum or maximum amount that a customer may wager at a particular table.

load. Coins or tokens put into a hopper.

machine payout. The number of coins paid out to the customer by a coin-operated gaming device as the result of a winning combination.

marker (IOU). A document, usually signed by the customer, evidencing an extension of credit to him by the casino.

marker button. *See* lammer button.

marker custodian. *See* pit clerk.

marker log. A detailed list of all marker transactions.

master card. *See* credit play memorandum.

master game report (game count sheet, stiff sheet, pit report). A form used to record, by shift and day, each table game's winnings and losses.

This form reflects the opening and closing table inventories, the fills and credits, and the drop and win.

meter. A mechanical apparatus in a coin-operated gaming device. May record the number of coins wagered, the number of coins dropped, the number of times the handle was pulled, or the number of coins paid out to winning players.

meter reading summary. A report reflecting the meter readings on coin-operated gaming devices. The number is recorded when the drop bucket is removed from the cabinet.

opener. The form on which the table inventory at the beginning of a shift is recorded.

outside ticket. A keno ticket given to a customer as a receipt, with the customer's selection of numbers and the amount wagered marked on it.

paid outs. The total amount of money paid to customers as winnings on various games, such as keno, bingo, race and sports books, and slots.

panguingui (pan). A card game similar to rummy, usually played in a poker room.

payment slip. That part of a marker form on which customer payments are recorded.

payoff. The amount paid out on a winning wager.

payout reserve container. *See* hopper.

payout schedule (award schedule card, award schedule). A statement, printed on cards, paper, plexiglass, and so on, of the payoffs or awards applicable to a particular game or device.

PC. *See* hold percentage.

pit. An area in a casino enclosed or encircled by gaming tables.

pit bank. A fund maintained in the pit area, usually in small casinos that do not have cages. Used for services normally provided by a cage cashier.

pit boss. The employee who supervises all games in a pit.

pit clerk (marker custodian). An employee at a desk in the pit who reports to the cage cashier and who prepares documentation such as requests for fills, requests for credits, and customer credit instruments.

pit master card. The form used to record credit activity at all tables in a pit area.

pit repayment. A customer's repayment of credit at a table.

pit report. *See* master game report.

placques. Rectangular, square, or oval objects used as chips. Used more frequently in foreign casinos and for very high denominations.

point spread. The number of points by which a team is favored to win a sporting event.

progressive slot machine. A slot machine, with a payoff indicator, in which the payoff increases as it is played.

puncher. The device used to punch holes in keno draw tickets. Also, the person punching the draw tickets.

rabbit ears. A device, generally V-shaped, that holds the numbered balls selected during a keno or bingo game so that the numbers are visible to players and employees.

race and sports book. A section in a casino where wagers are accepted on the outcome of sporting events.

rake-off (rake). A commission charged by the house for maintaining or dealing a game such as poker.

reel strip settings. Setting positions on slot machine reels so that they correspond to the calibrations regulating winning combinations and payoffs.

request for credit. A document prepared by a casino supervisor or pit clerk to authorize the preparation of a credit slip.

request for fill. A document prepared by a casino supervisor or pit clerk to authorize the preparation of a fill slip.

rim card. *See* credit play memorandum.

shift boss (manager). The executive with overall responsibility for casino operations during a shift.

shill (game starter). An employee financed by the house and acting as a player for the purpose of starting or maintaining a sufficient number of players in a game.

shoe. A device from which cards are dealt.

short pay. A payoff from a coin-operated gaming device that is less than the listed amount.

sleeper. A winning keno ticket not presented for payment or a winning bet left on the table through a player's forgetfulness.

slip dispenser (whiz machine). A locked device used primarily in a cage to dispense fill slips and credit slips in numerical sequence.

slot booth. A booth or small cage in the slot area that is used to provide change to customers, store change banks, make slot fills, and account for jackpot payouts.

slot drop count. *See* hard count.

slot fill. The coins placed in a hopper.

slot fill and payout sheet. A list of the slot fills and slot payouts.

slot machine. *See* coin-operated gaming device.

slot machine load. The initial slot fill.

slot supervisor. An individual with responsibility for a slot area and jackpots.

soft count. The count of the contents in a drop box.

squirrel cage. A holding unit used to mix balls before they are drawn in keno.

stickperson. The employee at the craps table who controls the dice, calls the numbers thrown, and is responsible for the speed of the game.

stiff sheet. *See* master game report.

table chip tray. A container used to hold coins and chips at a gaming table.

table inventory. The total coins, chips, and markers at a table.

theoretical hold. The intended hold percentage or win of an individual coin-operated gaming device as computed by reference to its payout schedule and reel strip settings.

theoretical hold sheet. A form that lists the characteristics of an individual coin-operated gaming device, such as reel settings, award schedule, number of coins that may be played, number of reels, theoretical hold, and other data applicable to a slot machine.

ticket acceptor. *See* cashless wagering system.

time buy-in. A fixed amount of money charged for the right to participate in certain games for a period of time.

tokens. A coinlike money substitute, in various denominations, used for gaming transactions.

tokes. Slang for gratuities given to casino employees by customers.

vault. A secure area within the casino where currency, coins, and chips are stored.

weigh count. The value of coins and currency counted by a weigh machine.

whiz machine. *See* slip dispenser.

win. *See* gross gaming revenue.

wrap. The procedure of wrapping coins. May also refer to the total amount or value of the wrapped coins.

write. The total amount wagered in keno, bingo, and race and sports book operations.

writer. An employee who writes keno or race and sports book tickets. A keno writer usually also makes payouts.

writer machine. A locked device used to prepare keno or race and sports book tickets.

Appendix G

Statement on Auditing Standards Cross-Referenced to Professional Standards AU sections—Transition Schedule[1]

Statement on Auditing Standards (SAS)	Title	AICPA *Professional Standards*, vol. 1, Cross-Reference (AU sec.)
SAS No. 1	*Responsibilities and Functions of the Independent Auditor*	AU sec. 110
	Due Professional Care in the Performance of Work	AU sec. 230
	Appointment of the Independent Auditor	AU sec. 310
SAS No. 22	*Planning and Supervision*	AU sec. 311
SAS No. 25	*The Relationship of Generally Accepted Auditing Standards to Quality Control Standards*	AU sec. 161
SAS No. 31	*Evidential Matter*	AU sec. 326
SAS No. 45	*Omnibus Statement on Auditing Standards—1983*, "Substantive Tests Prior to the Balance Sheet Date" and "Related Parties"	AU secs. 313 and 334
SAS No. 47	*Audit Risk and Materiality in Conducting an Audit*	AU sec. 312
SAS No. 48	*The Effects of Computer Processing on the Audit of Financial Statements*	AU secs. 311 and 326
SAS No. 54	*Illegal Acts by Clients*	AU sec. 317
SAS No. 55	*Consideration of Internal Control in a Financial Statement Audit*	AU sec. 319
SAS No. 56	*Analytical Procedures*	AU sec. 329

[1] The listing in this table should not be considered to be all-inclusive. For an all-inclusive listing of the Statement on Auditing Standards cross-referenced to the AU sections, readers should refer to the AICPA *Professional Standards*.

Statement on Auditing Standards (SAS)	Title	AICPA *Professional Standards*, vol. 1, Cross-Reference (AU sec.)
SAS No. 57	*Auditing Accounting Estimates*	AU sec. 342
SAS No. 58	*Reports on Audited Financial Statements*	AU sec. 508
SAS No. 59	*The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*	AU sec. 341
SAS No. 60	*Communication of Internal Control Related Matters Noted in an Audit*	AU sec. 325
SAS No. 61	*Communication With Audit Committees*	AU sec. 380
SAS No. 64	*Omnibus Statement on Auditing Standards—1990*	AU secs. 341, 508, and 543
SAS No. 65	*The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*	AU sec. 322
SAS No. 67	*The Confirmation Process*	AU sec. 330
SAS No. 78	*Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55*	AU sec. 319
SAS No. 80	*Amendment to Statement on Auditing Standards No. 31,* Evidential Matter	AU sec. 326
SAS No. 83	*Establishing an Understanding With the Client*	AU sec. 310
SAS No. 85	*Management Representations*	AU sec. 333
SAS No. 89	*Audit Adjustments*	AU secs. 310, 333, and 380
SAS No. 93	*Omnibus Statement on Auditing Standards—2000*	AU secs. 315, 411, 508, and 622

Statement on Auditing Standards (SAS)	**Title**	**AICPA *Professional Standards*, vol. 1, Cross-Reference (AU sec.)**
SAS No. 94	*The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit*	AU sec. 319
SAS No. 95	*Generally Accepted Auditing Standards*	AU sec. 150
SAS No. 96	*Audit Documentation*	AU secs. 312, 329, 339, and 341
SAS No. 98	*Omnibus Statement on Auditing Standards—2002*	AU secs. 150, 161, 312, 324, 508, 530, 550, 551, 558, 560, and 561
SAS No. 99	*Consideration of Fraud in a Financial Statement Audit*	AU secs. 230, 316, and 333

Appendix H

Schedule of Changes Made to Casinos

As of May 2005

Beginning May 2001, all schedules of changes reflect only current year activity for improved clarity.

Reference	Change
General	Deleted referencing to the originally issued Statement on Auditing Standards (SAS) or Statement on Standards for Attestation Engagements (SSAE); Modified AICPA *Professional Standards* presentation.
Preface	Updated to reflect revised referencing and applicability of PCAOB Standards; Updated information concerning the proposed eight new Statements on Auditing Standards; Updated and revised Sarbanes-Oxley guidance for Issuers and auditors of Issuers.
Paragraphs 1.08, 1.10, (Heading), 1.15, 1.17, 1.19, and 1.21	Revised to clarify guidance.
Paragraphs 1.22 and 1.23	Added to clarify guidance; Subsequent paragraphs renumbered.
Renumbered paragraph 1.34	Revised to clarify guidance.
Paragraph 2.02 (Heading) (footnote *)	Deleted.
Paragraph 2.05	Revised to clarify guidance.
Paragraphs 2.14 and 2.15	Corrected placement of existing guidance.
Paragraph 2.16 (Heading) (footnote 3)	Deleted.
Paragraph 2.16	Transferred to new paragraph 2.21 and revised to clarify guidance for nonpublic enterprises.
Paragraphs 2.16, 2.17, 2.18, 2.19, 2.20, and footnote 3	Added to reflect scope of casino operations and the issuance of FASB Statement No. 131 and EITF Issue No. 04-10.
Paragraph 2.21	Formerly paragraph 2.16; Revised to clarify guidance for nonpublic enterprises.
Chapter 3 (Title and footnote *)	Revised; Added.

Reference	Change
Paragraph 3.01	Added to provide an introduction to the section of the chapter; Subsequent paragraphs renumbered.
Renumbered paragraph 3.02 (Heading)	Added.
Renumbered paragraphs 3.02 and 3.04	Revised to include PCAOB Auditing Standards guidance; Footnotes * and † deleted; Footnote † added.
Renumbered paragraph 3.05	Revised to include Management Representation (AU sec. 333), guidance PCAOB Auditing Standards guidance, and specific casino examples; Footnote 1 deleted; Subsequent footnotes renumbered.
Renumbered paragraph 3.06	Revised to reflect PCAOB Auditing Standards guidance.
Paragraphs 3.07, 3.08, 3.09, 3.10, 3.11, 3.12, 3.13 (and footnote ‡), 3.14, 3.15, 3.16, 3.17, 3.18, and 3.19	Added to reflect guidance on the audit planning process, client understanding, audit objectives, related party transactions, audit risk and materiality, accounting estimates, and going concern considerations; Subsequent paragraphs further renumbered.
Renumbered paragraph 3.20 (Heading) (footnote ‡)	Deleted.
Renumbered paragraph 3.22 (renumbered footnote 2)	Revised to remove proposed risk assessment standards.
Paragraph 3.25	Added to reflect the issuance of PCAOB Auditing Standard No. 3; Subsequent paragraphs further renumbered.
Renumbered paragraph 3.26	Revised to clarify guidance; Added PCAOB Auditing Standards guidance; Footnote ‡ added.
Paragraph 3.31	Added to include fraud risk factor guidance (AU sec. 316) specific to casinos; Subsequent paragraphs further renumbered.
Renumbered paragraph 3.33	Added casino industry specific examples for identifying areas for further investigation.
Renumbered paragraph 3.37	Added casino industry specific factors when considering material misstatements due to fraud relating to revenue recognition.
Renumbered paragraph 3.39	Added additional key casino estimates.
Renumbered paragraph 3.40	Added specific casino industry examples of programs and controls.

Reference	Change
Renumbered paragraph 3.41	Revised to clarify guidance.
Renumbered paragraph 3.46 (and renumbered footnote 5)	Revised to reflect PCAOB Auditing Standards guidance.
Renumbered paragraph 3.50	Revised to clarify guidance.
Paragraphs 3.51, 3.52, 3.53, and 3.54	Added to reflect authoritative guidance; Subsequent paragraphs further renumbered.
Chapter 4 (Title) (footnote *)	Replaced.
Paragraph 4.08 (and footnote 1)	Revised to clarify guidance.
Paragraph 4.11	Revised to clarify guidance; Added PCAOB Auditing Standards guidance.
Paragraph 4.13	Revised to clarify guidance; Footnote † deleted; Footnote 2 revised to reflect PCAOB Auditing Standards guidance.
Paragraph 4.14 and footnote †	Added to reflect the issuance of PCAOB Auditing Standard No. 2; Subsequent paragraphs renumbered.
Renumbered paragraph 4.15	Revised to clarify guidance.
Renumbered paragraph 4.16	Revised to clarify guidance; Added PCAOB Auditing Standards guidance.
Chapter 5 (Title)	Footnote * revised; Footnote † added.
Paragraph 5.01 (footnotes 1 and 2)	Added to include guidance regarding analytical procedures and substantive tests.
Paragraph 5.02	Added PCAOB Auditing Standards guidance.
Paragraphs 5.03 and 5.04	Added to provide guidance regarding the design of substantive analytical procedures; Subsequent paragraphs renumbered.
Paragraphs 6.06, 6.17, 6.21, and 6.23	Revised to clarify guidance.
Chapter 7 (Title) (footnote *)	Added.
Paragraph 7.04	Revised to clarify guidance.
Paragraph 7.05 (footnote 1)	Revised to reflect the issuance of FASB Statement No. 123 (revised) and FASB Statement No. 133 implementation guidance.
Paragraphs 7.12 and 7.21	Revised to clarify guidance.

Reference	Change
Paragraph 7.22	Added PCAOB Auditing Standards guidance.
Paragraph 8.02	Revised to clarify guidance.
Paragraph 8.04	Updated dates to reflect 2004 and 2003, respectively; Updated report date; Included optional language for an audit that includes consideration of internal control over financial reporting; Added additional guidance when performing integrated audits of financial statements and internal control over financial reporting; Deleted existing footnote *; Added footnote 2; Added new footnote *. Subsequent footnotes renumbered.
Paragraph 8.05	Updated dates to reflect 2004 and 2003, respectively.
Paragraph 8.06	Updated dates to reflect 2004 and 2003, respectively; Renumbered footnote 4 revised to reflect the issuance of FASB Statement No. 123 (revised).
Paragraph 8.08	*Note 1:* Revised footnote 5 to clarify guidance; Added footnote 6 to reflect the issuance of FASB Staff Position FAS 109-1; Subsequent footnotes renumbered; *Note 2:* Revised renumbered footnote 7 to clarify guidance and update dates to reflect 2004 and 2003, respectively; *Notes 3 and 4:* Updated dates to reflect 2004 and 2003, respectively; *Notes 5 and 6:* Updated various dates; Added footnote 8 to provide guidance regarding EITF Issue No. 03-1; Subsequent footnotes renumbered; *Note 8:* Updated date to reflect 2003; Renumbered footnote 9 revised to reflect the issuance of FASB Statement No. 123 (revised); *Note 9:* Deleted former footnote 4.
Chapter 9 (Title) (footnote *)	Replaced.
Paragraph 9.01	Added to include SSAE (AT sec. 501) and PCAOB Auditing Standard guidance; Deleted superseded guidance; Deleted footnotes 2 and †; Subsequent paragraphs and footnotes renumbered.
Renumbered paragraph 9.02	Added PCAOB Auditing Standards guidance; Footnote 2 added to clarify guidance.
Renumbered paragraph 9.04 (Heading) (footnote 3)	Added to reflect the guidance for reporting under AT sec. 501.
Renumbered paragraph 9.06	Revised to clarify guidance.

Reference	Change
Renumbered paragraph 9.07 (renumbered footnote 4)	Replaced.
Renumbered paragraphs 9.08 and 9.09	Added PCAOB Auditing Standards Guidance.
Former paragraph 9.09	Deleted.
Appendix E	Updated.
Appendix G	Added; Subsequent appendix relettered.

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