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AUDIT & ACCOUNTING GUIDE

Gaming

NEW EDITION AS OF MARCH 1, 2011



Audit & Accounting Guide: Gaming

March 1, 2011



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AUDIT & ACCOUNTING GUIDE

Gaming

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Preface

About AICPA Audit and Accounting Guides

The AICPA Audit and Accounting Guide *Gaming* has been developed by the AICPA Gaming Guide Task Force to assist management in the preparation of their financial statements in conformity with U.S. generally accepted accounting principles (GAAP) and to assist auditors in auditing and reporting on such financial statements.

The financial accounting and reporting guidance contained in this guide, when developed by the original task force, was approved by the affirmative vote of at least two-thirds of the members of the Accounting Standards Executive Committee (AcSEC), now the Financial Reporting Executive Committee (FinREC). FinREC is the senior technical body of the AICPA authorized to speak for the AICPA in the areas of financial accounting and reporting. Conforming updates made to the financial accounting and reporting guidance contained in this guide in years subsequent to the original development are reviewed by select FinREC members, among other reviewers, where applicable.

This guide does the following:

- Identifies certain requirements set forth in the Financial Accounting Standards Board (FASB) *Accounting Standards Codification*TM (ASC) and the Governmental Accounting Standards Board (GASB).
- Describes FinREC's understanding of prevalent or sole industry practice concerning certain issues. In addition, this guide may indicate that FinREC expresses a preference for the prevalent or sole industry practice, or it may indicate that FinREC expresses a preference for another practice that is not the prevalent or sole industry practice; alternatively, FinREC may express no view on the matter.
- Identifies certain other, but not necessarily all, industry practices concerning certain accounting issues without expressing FinREC's views on them.
- Provides guidance that has been supported by FinREC on the accounting, reporting, or disclosure treatment of transactions or events that are not set forth in FASB ASC.

Accounting guidance for nongovernmental entities included in an AICPA Audit and Accounting Guide is a source of nonauthoritative accounting guidance. As discussed later in this preface, FASB ASC is the authoritative source of U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the Securities and Exchange Commission (SEC).

Accounting guidance for governmental entities included in an AICPA Audit and Accounting Guide is a source of authoritative accounting guidance, as described in category (b) of the hierarchy of GAAP for state and local government entities and has been cleared by GASB. AICPA members should be prepared to justify departures from GAAP as discussed in Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, ET sec. 203 par. .01).

Auditing guidance included in an AICPA Audit and Accounting Guide is recognized as an interpretive publication pursuant to AU section 150, *Generally*

Accepted Auditing Standards (AICPA, *Professional Standards*). Interpretive publications are recommendations on the application of Statements on Auditing Standards (SASs) in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the Auditing Standards Board (ASB) after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SASs. The members of the ASB have found this guide to be consistent with existing SASs.

The auditor should be aware of and consider interpretive publications applicable to his or her audit. If an 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.

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Guidance Considered in This Edition

The edition of this guide includes authoritative guidance issued through March 1, 2011. Authoritative guidance discussed in the text of the guide (as differentiated from the temporary footnotes, which are denoted by a symbol rather than a number) is effective for entities with fiscal years *ending* on or before March 1, 2011. Authoritative guidance discussed only in temporary footnotes is not yet effective as of March 1, 2011, for entities with fiscal years ending after that same date.

This includes relevant guidance issued up to and including the following:

- FASB Accounting Standards Update (ASU) No. 2011-02, *Receivables (Topic 310): Deferral of the Elective Date of Disclosures about Troubled Debt Restructuring*
- GASB statements, interpretations, and technical bulletins issued through March 1, 2011
- GASB *Comprehensive Implementation Guide* as of June 30, 2010
- SAS No. 121, *Revised Applicability of Statement on Auditing Standards No. 100*, Interim Financial Information (AICPA, *Professional Standards*, AU sec. 722 par. .05)
- Interpretation No. 19, "Financial Statements Prepared in Conformity With International Financial Reporting Standards as Issued by the International Accounting Standards Board," of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, AU sec. 9508 par. .93–97)
- Revised interpretations issued through March 1, 2011, including Interpretation Nos. 1–4 of AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, AU sec. 9325 par. .01–.13)
- Statement of Position 09-1, *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagging Data* (AICPA, *Technical Practice Aids*, AUD sec. 14,440)
- Statement on Standards for Attestation Engagements No. 17, *Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence Is Impaired* (AICPA, *Professional Standards*, AT sec. 301 par. .23)
- Interpretation No. 7, "Reporting on the Design of Internal Control" of AT section 101, *Attest Engagements* (AICPA, *Professional Standards*, AT sec. 9101 par. .59–.69)

- Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 15, *Audit Evidence* (AICPA, *PCAOB Standards and Related Rules*, Auditing Standards)

Users of this guide should consider guidance issued subsequent to those items previously listed to determine their effect on entities covered by this guide. In determining the applicability of recently issued guidance, its effective date should also be considered.

Applicability of U.S. Generally Accepted Auditing Standards and PCAOB Standards

Audits of the financial statements of *nonissuers* (those entities not subject to the Sarbanes-Oxley Act of 2002 or the rules of the SEC—that is, private entities, generally speaking) are conducted in accordance with U.S. generally accepted auditing standards (GAAS) as issued by the ASB, the senior technical committee of the AICPA with the authority to promulgate auditing standards for nonissuers. The ASB develops and issues standards in the form of SASs through a due process that includes deliberation in meetings open to the public, public exposure of proposed SASs, and a formal vote. The SASs and their related interpretations are codified in the AICPA's *Professional Standards*. Paragraph .03 of AU section 150 establishes that an AICPA member's failure to follow ASB standards for audits of nonissuers is a violation of Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, ET sec. 202 par. .01), of the AICPA Code of Professional Conduct.

Audits of the financial statements of *issuers*, as defined by the SEC (those entities subject to the Sarbanes-Oxley Act of 2002 or the rules of the SEC—that is, public entities, generally speaking), are conducted in accordance with standards established by the PCAOB, a private sector, nonprofit corporation created by the Sarbanes-Oxley Act of 2002 to oversee the audits of issuers. The SEC has oversight authority over the PCAOB, including the approval of its rules, standards, and budget.

For audits of a nonissuer, in accordance with both GAAS and PCAOB standards, Interpretation No. 18, "Reference to PCAOB Standards in an Audit Report on a Nonissuer," of AU section 508 (AICPA, *Professional Standards*, AU sec. 9508 par. .89–.92), provides reporting guidance applicable to such engagements.

References to Professional Standards

In citing GAAS and its related interpretations, references use section numbers within the codification of currently effective SASs, not the original statement number, as appropriate. For example, SAS No. 54, *Illegal Acts by Clients*, is referred to as AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*). In those sections of the guides that refer to specific auditing standards of the PCAOB, references are made to the AICPA's *PCAOB Standards and Related Rules* publication.

FASB Accounting Standards Codification™

Overview

Released on July 1, 2009, FASB ASC is a major restructuring of accounting and reporting standards designed to simplify user access to all authoritative U.S. GAAP by topically organizing the authoritative literature. FASB ASC disassembled and reassembled thousands of nongovernmental accounting pronouncements (including those of FASB, the Emerging Issues Task Force, and the AICPA) to organize them under approximately 90 topics.

FASB ASC also includes relevant portions of authoritative content issued by the SEC, as well as selected SEC staff interpretations and administrative guidance issued by the SEC; however, FASB ASC is not the official source of SEC guidance and does not contain the entire population of SEC rules, regulations, interpretive releases, and SEC staff guidance. Moreover, FASB ASC does not include governmental accounting standards.

FASB published a notice to constituents that explains the scope, structure, and usage of consistent terminology of FASB ASC. Constituents are encouraged to read this notice to constituents because it answers many common questions about FASB ASC. FASB ASC, and its related notice to constituents, can be accessed at <http://asc.fasb.org/home> and are also offered by certain third party licensees, including the AICPA. FASB ASC is offered by FASB at no charge in a Basic View and for an annual fee in a Professional View.

Issuance of Amendments to FASB ASC

Amendments to FASB ASC are now issued through ASUs and serve only to update FASB ASC. FASB does not consider the ASUs authoritative in their own right; such amendments become authoritative when they are incorporated into FASB ASC.

The ASUs issued are in the form of ASU No. 20YY-XX, in which "YY" is the last two digits of the year and "XX" is the sequential number for each update. For example, ASU No. 2011-01 is the first update in the calendar year 2011. The ASUs include the amendments to the codification and an appendix of FASB ASC update instructions. ASUs also provide background information about the amendments and explain the basis for FASB's decisions.

Pending Content in FASB ASC

Amendments to FASB ASC issued in the form of ASUs (or other authoritative accounting guidance issued prior to the release date of FASB ASC) that are not fully effective, or became effective within that last six months, for all entities or transactions within its scope are reflected as "Pending Content" in FASB ASC. This pending content is shown in text boxes below the paragraphs being amended in FASB ASC and includes links to the transition information. The pending content boxes are meant to provide users with information about how a paragraph will change when new guidance becomes authoritative. When an amended paragraph has been fully effective for six months, the outdated guidance will be removed, and the amended paragraph will remain without the pending content box. FASB will keep any outdated guidance in the applicable archive section of FASB ASC for historical purposes.

Because not all entities have the same fiscal year-ends, and certain guidance may be effective on different dates for public and nonpublic entities, the pending

content will apply to different entities at different times. As such, pending content will remain in place within FASB ASC until the "roll off" date. Generally, the roll off date is six months following the latest fiscal year-end for which the original guidance being amended or superseded by the pending content could be applied as specified by the transition guidance. For example, assume an ASU has an effective date for fiscal years beginning after November 15, 2010. The latest possible fiscal year-end of an entity still eligible to apply the original guidance being amended or superseded by the pending content would begin November 15, 2010, and end November 14, 2011. Accordingly, the roll off date would be May 14, 2012.

Entities cannot disregard the pending content boxes in FASB ASC. Instead, all entities must review the transition guidance to determine when the pending content is applicable to them. This Audit and Accounting Guide identifies pending content, when applicable. As explained in the section of the preface, "Guidance Considered in This Edition," pending content discussed in the text of the guide (as differentiated from the temporary footnotes, which are denoted by a symbol rather than a number) is effective for entities with fiscal years *ending* on or before March 1, 2011. Pending content discussed only in temporary footnotes is not yet effective as of January 1, 2011, for entities with fiscal years ending after that same date.

New AICPA.org Website

The AICPA encourages you to visit the new website at www.aicpa.org. It was launched in 2010 and provides significantly enhanced functionality and content critical to the success of AICPA members and other constituents. Certain content on the AICPA's website referenced in this guide may be restricted to AICPA members only.

Select Recent Developments Significant to This Guide

Summary of Significant Differences Between PCAOB and AICPA Risk Assessment Standards

On August 5, 2010, the PCAOB issued Release No. 2010-004, *Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards* (AICPA, *PCAOB Standards and Related Rules*, Select PCAOB Releases). This release includes eight auditing standards (collectively referred to as the PCAOB risk assessment standards) as adopted by the PCAOB. The eight standards, which were approved by the SEC on December 23, 2010, are as follows:

- Auditing Standard No. 8, *Audit Risk*
- Auditing Standard No. 9, *Audit Planning*
- Auditing Standard No. 10, *Supervision of the Audit Engagement*
- Auditing Standard No. 11, *Consideration of Materiality in Planning and Performing an Audit*
- Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*

- Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*
- Auditing Standard No. 14, *Evaluating Audit Results*
- Auditing Standard No. 15, *Audit Evidence*

The release also includes conforming amendments to other interim standards related to the PCAOB risk assessment standards. The effective date of the PCAOB risk assessment standards is for audits of financial statements of issuers with fiscal periods beginning on or after December 15, 2010.

In general, the PCAOB risk assessment standards are consistent with the AICPA SASs related to risk assessment (the AICPA risk assessment standards). Where differences exist, they are primarily due to the PCAOB

- a. addressing audits of financial statements in conjunction with audits of effectiveness of internal control (often referred to as integrated audits). The AICPA risk assessment standards only address audits of financial statements.
- b. presenting content in standards different than the AICPA risk assessment standards. For example, the PCAOB
 - i. incorporated fraud risk assessment procedures into the PCAOB risk assessment standards.
 - ii. created Auditing Standard No. 10 to separately address supervision of the audit engagement.
 - iii. created Auditing Standard No. 14 to separately address the evaluation of audit results.
 - iv. moved content related to other audit areas, such as analytical review procedures and audits of group financial statements.

The PCAOB risk assessment standards are not as voluminous as the AICPA risk assessment standards because the PCAOB standards do not contain as much application guidance as do the AICPA risk assessment standards. Appendix 11, "Comparison of the Objectives and Requirements of the Accompanying PCAOB Auditing Standards with the Analogous Standards of the International Auditing and Assurance Standards Board and the Auditing Standards Board of the American Institute of Certified Public Accountants," of the release contains a more detailed comparison of the differences between the PCAOB risk assessment standards and the AICPA risk assessment standards.

ASB's Clarity Project

In an effort to make GAAS easier to read, understand, and apply, the ASB launched the Clarity Project. When completed, clarified auditing standards will be issued as one SAS that will supersede all prior SASs. The new auditing standards are expected to apply to audits of financial statements for periods ending on or after December 15, 2012.

The foundation of the ASB's Clarity Project is the establishment of an objective for each auditing standard. These objectives will better reflect a principles-based approach to standard-setting. In addition to having objectives, the clarified standards will reflect new drafting conventions that include the following:

- Adding a definitions section, if relevant, in each standard
- Separating requirements from application and other explanatory material
- Numbering application and other explanatory material paragraphs using an A prefix and presenting them in a separate section (following the requirements section)
- Using formatting techniques, such as bulleted lists, to enhance readability
- Adding special considerations relevant to audits of smaller, less complex entities
- Adding special considerations relevant to audits of governmental entities

The project also has an international convergence component. The ASB expects that, upon completion of the project, the requirements of U.S. GAAS will be converged with those of the International Auditing and Assurance Standards Board. AICPA Audit and Accounting Guides, as well as other AICPA publications, will be conformed to reflect the new standards resulting from the Clarity Project after issuance and as appropriate based on the effective dates.

International Financial Reporting Standards

International Financial Reporting Standards (IFRSs) consist of accounting standards and interpretations developed and issued by the International Accounting Standards Board (IASB), a London-based independent accounting standard-setting body. The IASB began operations in 2001, when it succeeded the International Accounting Standards Committee (IASC). The IASC was formed in 1973, soon after the formation of FASB. In 2001, when the IASB replaced the IASC, a new, independent oversight body, the IASC Foundation, was created to appoint the members of the IASB and oversee its due process. The IASC Foundation's oversight role is very similar to that of the Financial Accounting Foundation (FAF) in its capacity as the oversight body of FASB.

The term *IFRSs* has both a narrow and a broad meaning. Narrowly, IFRSs refer to the new numbered series of pronouncements issued by the IASB, as differentiated from International Accounting Standards (IASs) issued by its predecessor, the IASC. More broadly, however, IFRSs refer to the entire body of authoritative IASB pronouncements, including those issued by the IASC and their respective interpretive bodies. Therefore, the authoritative IFRSs literature, in its broadest sense, includes the following:

- Standards, whether labeled IFRSs or IASs
- Interpretations, whether issued by the IFRS Interpretations Committee (the interpretive body of the IFRS Foundation), the International Financial Reporting Interpretations Committee (IFRIC, predecessor to the IFRS Interpretations Committee), or the Standing Interpretations Committee (the predecessor to IFRIC)
- IFRSs framework

As of March 31, 2010, IFRIC formally changed its name to the IFRS Interpretations Committee and on July 1, 2010, the IASC Foundation formally changed its name to the IFRS Foundation.

The preface to the IFRS 2010 bound volume states that IFRSs are designed to apply to the general purpose financial statements and other financial reporting

of all profit-oriented entities, including commercial, industrial, and financial entities regardless of legal form or organization. Included within the scope of profit-oriented entities are mutual insurance companies and other mutual cooperative entities providing dividends or other economic benefits to their owners, members, or participants.

IFRSs are not designed to apply to not-for-profit entities or those in the public sector, but these entities may find IFRSs appropriate in accounting for their activities. In contrast, U.S. GAAP is designed to apply to all nongovernmental entities, including not-for-profit entities, and includes specific guidance for not-for-profit entities, development stage entities, limited liability entities, and personal financial statements.

The AICPA Governing Council voted in May 2008 to recognize the IASB as an accounting body for purposes of establishing international financial accounting and reporting principles. This amendment to appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards," of Rules 202 and 203 of the AICPA's Code of Professional Conduct gives AICPA members the option to use IFRSs as an alternative to U.S. GAAP. As a result, private entities in the United States can prepare their financial statements in accordance with U.S. GAAP as promulgated by FASB; an other comprehensive basis of accounting, such as cash- or tax-basis; or IFRS, among others. However, domestic issuers are currently required to follow U.S. GAAP and rules and regulations of the SEC. In contrast, foreign private issuers may present their financial statements in accordance with IFRS as issued by the IASB without a reconciliation to U.S. GAAP, or in accordance with non-IFRS home-country GAAP reconciled to U.S. GAAP as permitted by Form 20-F.

The growing acceptance of IFRSs as a basis for U.S. financial reporting could represent a fundamental change for the U.S. accounting profession. Acceptance of a single set of high-quality accounting standards for worldwide use by public companies has been gaining momentum around the globe for the past few years. See appendix F, "International Financial Reporting Standards," for a discerning look at the status of convergence with IFRSs in the United States and the important issues that accounting professionals need to consider now.

Private Company Financial Reporting Blue Ribbon Panel

The Blue Ribbon Panel on Private Company Financial Reporting was established in December 2009 and is sponsored by the AICPA, FAF, and the National Association of State Boards of Accountancy. This panel was formed to consider how U.S. accounting standards can best meet the needs of users of private company financial statements. Members of the panel represent a cross-section of financial reporting constituencies, including lenders, investors, owners, preparers, and auditors.

In late 2010, the Blue Ribbon Panel voted to recommend that FAF accept a new standard-setting model for private companies and the creation of a separate board to set those standards. In January 2011, the Blue Ribbon Panel submitted a report of its recommendations to FAF. Work continues related to changes being considered for private company financial reporting. For more information, visit www.accountingfoundation.org/home.

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Chapter 1

Industry Overview

Gaming in the United States

Casino Gaming

1.01 The modern era of gaming in the United States began in 1931 in Nevada, when the so-called "wide-open gaming bill" was passed. The passage of the bill was precipitated by (a) dissatisfaction with widespread illegal gaming, (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.

1.02 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, gaming became big business.

1.03 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 on licensing and disciplinary matters, and the Gaming Control Board was established as the active operating regulatory authority over the daily activities of Nevada casinos.

1.04 Gaming became a licensed and strictly regulated activity throughout Nevada. In the late 1960s, under pressure from the federal government, Nevada passed the Corporate Gaming Act. This heralded the era of public corporate ownership and created the framework for regulation of the industry.

1.05 In 1976, New Jersey voters passed a referendum allowing casino gaming in Atlantic City. It was hoped that casino gaming would contribute to the redevelopment of Atlantic City. In 1978, the first Atlantic City casino, Resorts International, opened on the boardwalk. By the early 1990s, 13 casinos resided on the boardwalk and in its marina area.

1.06 The proliferation of gaming continued and spread outside of the Nevada and New Jersey markets and into the newly formed riverboat gaming markets. In July 1989, Iowa legalized riverboat gaming, and eight other states followed suit.

1.07 Commercial casinos include land based, limited stakes, riverboat, dockside, and racetrack casinos (such facilities are commonly referred to as racinos, which are racetracks where *slot machines*¹ or *video lottery terminals* have also been installed). Such forms of gaming are currently conducted in numerous states. Much of the revenue growth in gaming has resulted from the introduction of gaming into new jurisdictions. Land-based casinos traditionally

¹ Terms that appear in the glossary are shown in *italics* the first time they appear.

include slot machines, table games, race and sports books, bingo, and keno. (See table 1-1 in paragraph 1.19)

1.08 Each state provides regulations for the gaming format, whether there are limitations on betting limits and hours of operation, admission fees, and the tax rate(s) and how they are collected and spent.

1.09 Gaming 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.

Native American Gaming

1.10 Legalized gaming in the United States includes gaming activities sanctioned and conducted by Native American tribes. Native American gaming is regulated in three ways: by the federal government through the National Indian Gaming Commission, by states through authority granted by the negotiated tribal state compacts, and by individual tribes through their gaming regulatory authorities established for that purpose. A *compact* is an intergovernmental agreement between a tribal government and a state government. The Indian Gaming Regulatory Act of 1988 (IGRA) requires negotiation of such compacts as the legal basis for Native American gaming.

1.11 IGRA classified gaming into three classifications:

- Class I provides for social or traditional games played in conjunction with tribal ceremonies.
- Class II provides for bingo and other related games that would normally be played in conjunction with bingo, such as *pulltabs* and punchboards; other related gaming activities are also included in this class.
- Class III provides for such games as slot machines, house-banked table games, and keno.

Regulations of each class of gaming are determined by tribal-state compacts and the provisions of IGRA.

Lotteries

1.12 A *lottery* is a popular form of gaming that involves the drawing of lots for a prize. Lotteries have been conducted in various forms for centuries and are typically operated by government agencies or charitable organizations. In the United States, lotteries are typically operated by state governments and are subject to the laws of each state. The first modern state lottery was established in New Hampshire in 1964, and currently 42 states and the District of Columbia operate some form of a lottery. Additionally, lottery associations operate interstate lottery games (for example, Powerball, Mega Millions), which results in increased ticket sales and larger payouts than normally found in a single state lottery.

1.13 Whereas a traditional gaming entity operates games solely at the licensed gaming facility, a lottery uses authorized agents at retail outlets to sell lottery tickets and cash winning tickets. The use of off-site agents is a significant difference between a traditional gaming entity's operations and lotteries. The various methods of conducting lotteries are described in appendix E, "Rules of the Games."

1.14 Lotteries are entitled to proceeds from the sale of *lotto tickets* and *instant game tickets* and are responsible for payouts on winning tickets. Agents receive a commission based on a percentage of the dollar amount of tickets sold. Agents may also receive other payments, such as a bonus, when a super lotto ticket wins at the agent's retail outlet. The win from video lottery terminals will typically be shared between the agent and the lottery at a rate determined by statute or regulation. A reconciliation is typically performed on a weekly basis, taking into consideration agent ticket sales, payouts, and commissions, with an electronic funds transfer made either to or from the central lottery office, depending on cash flow at the retail outlet for that week. Lotteries also typically generate revenues from license fees collected from the agents.

1.15 Proceeds from ticket sales are distributed pursuant to legislative or regulatory allocation requirements. For example, a typical breakdown would be (a) 55 percent returned to patrons as prizes; (b) 33 percent to fund education, health care, transportation, or other similar state budget items; (c) 7 percent commission to agents; and (d) 5 percent to fund lottery operating costs.

1.16 As governmental entities, state lotteries apply governmental accounting standards and financial reporting practices and should refer to the guidance in chapter 12, "Governmental Gaming Entities."

Other Gaming

1.17 Gaming is also conducted through various charitable organizations, through slot routes at convenience and grocery stores, on cruise ships, and on horse and greyhound races at race tracks and off-track betting sites. Cruise ship gaming is typically conducted only in international waters, where U.S. laws do not apply.

1.18 Gaming has proliferated across the United States in recent years and is now available in some form in every state except Hawaii and Utah. Proliferation is likely to continue as states use taxes and license fees to supplement state budgets.

1.19 The following table illustrates legalized gaming activities throughout the United States.

Table 1-1

Nature of Legalized Gaming Throughout the United States

State	Land based ¹	Riverboat	Native American ²	Card room	Lottery ³	Bingo	Racino ⁴	None
Alabama			X			X		
Alaska			X			X		
Arizona			X		X	X		
Arkansas					X	X		
California			X	X	X	X		
Colorado	X		X		X	X		
Connecticut			X		X	X		
Delaware					X	X	X	
Florida			X	X	X	X	X	

(continued)

Gaming

State	Land based ¹	Riverboat	Native American ²	Card room	Lottery ³	Bingo	Racino ⁴	None
Georgia					X	X		
Hawaii								X
Idaho			X		X	X		
Illinois		X			X	X		
Indiana		X			X	X		
Iowa		X	X		X	X	X	
Kansas	X	X	X		X	X		
Kentucky					X	X		
Louisiana	X	X	X		X	X	X	
Maine					X	X	X	
Maryland					X	X		
Massachusetts					X	X		
Michigan	X		X		X	X		
Minnesota			X	X	X	X		
Mississippi	X	X	X			X		
Missouri		X	X		X	X		
Montana			X	X	X	X		
Nebraska			X		X	X		
Nevada	X					X		
New Hampshire					X	X		
New Jersey	X				X	X		
New Mexico			X		X	X	X	
New York			X		X	X	X	
North Carolina			X		X	X		
North Dakota			X		X	X		
Ohio					X	X		
Oklahoma			X		X	X	X	
Oregon			X		X	X		
Pennsylvania	X				X	X	X	
Rhode Island					X	X	X	
South Carolina					X	X		
South Dakota	X		X		X	X		
Tennessee					X			
Texas			X		X	X		
Utah								X
Vermont					X	X		
Virginia					X	X		
Washington			X	X	X	X		
Washington, DC					X	X		

State	Land based ¹	Riverboat	Native American ²	Card room	Lottery ³	Bingo	Racino ⁴	None
West Virginia					X	X	X	
Wisconsin			X		X	X		
Wyoming			X			X		
Number of states	8	6	28	5	43	47	11	2
¹ Land based gaming in Mississippi passed in 2006 for coastal casinos only. Land based gaming in Colorado is limited stakes. ² Class II gaming only currently in Alabama, Alaska, Florida, Nebraska, and Texas. ³ Includes Powerball, Mega Millions, and state lotteries. ⁴ Delaware, New Mexico, and Rhode Island use video lottery terminals.								

1.20 Limited stakes gaming represents gaming operations in which only slot machines and table games with relatively low maximum bet limits are permitted.

1.21 Card rooms allow only nonbanked table games, and in the state of Washington, restrict the number of tables and betting limits.

1.22 Internet gaming companies have been formed to provide online gaming and sports betting over the Internet. The legality of such forms of gaming continues to be debated and challenged throughout the world and is still illegal in the United States. U.S. gaming corporations generally have avoided entering into Internet gaming opportunities because such activities may jeopardize their gaming licenses in U.S. jurisdictions.

1.23 Many gaming facilities have become large scale, destination resorts. Owners 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, convention facilities, entertainment, and retail operations.

1.24 Gaming equipment manufacturers have also developed structures whereby they conduct gaming activities. The gaming equipment manufacturer may maintain ownership of the machine and also may share in the proceeds from the gaming activities.²

Regulation and Oversight

1.25 The ownership and operation of gaming facilities in the United States are subject to a number of state, local, and tribal laws, regulations, and ordinances. These laws and regulations concern the responsibility, financial stability, and character of gaming operators and persons financially interested or involved in gaming operations.

1.26 Gaming entities are licensed by state, local, and tribal gaming regulatory authorities. The licenses are not transferable and may be renewed periodically. The licensing authorities have broad discretion in granting and renewing licenses.

² It should be noted that the scope of this guide covers these gaming activities, but does not otherwise apply to the accounting and auditing of other activities of gaming manufacturers, such as inventory or nongaming-related revenue recognition.

1.27 Officers, directors, and certain key employees of a gaming entity must be licensed by the gaming regulatory authorities, and employees associated with gaming must obtain licenses, work permits, or employee registrations. The gaming authorities have the power to require the gaming entity 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 entities that service the gaming industry to also be licensed.

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

1.29 No person may acquire control of a gaming entity (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 gaming entity 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.

1.30 To be licensed, the gaming entity may give up certain management flexibility and may also be 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 gaming entities, 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) purchases of gaming equipment.

1.31 For the operating methods that the gaming entities 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.

1.32 Gaming entities are generally required to file with regulatory agencies reports describing, in narrative and diagrammatic form, detailed operating procedures for gaming and gaming related activities that meet certain specified minimum standards. An accounting system and internal control policies and procedures must be established before a gaming entity's operations begin. The systems, and any significant revisions to them, may be evaluated and reported on by an independent auditor and are subject to review by the regulatory agencies.

1.33 Gaming entities are generally charged a fee or tax based on a percent of gross gaming revenue by the state in which they operate. Such fees are often also assessed by tribal governments on gaming entities operating within their jurisdiction. County and city license fees are also common. Local jurisdictions sometimes require a gaming entity to pay a deposit to ensure that the locality receives the tax revenue even if the gaming entity ceases to operate.

1.34 In addition to the gross revenue fee or tax imposed by states, tribes, and local governments, the federal government imposes taxes and fees on

certain gaming activities. For example, a wagering tax is levied by the federal government on race and sports book operators. This tax is based on a percentage of the amount wagered by customers.

1.35 In addition to the aforementioned fees and taxes, the operating costs of gaming, regulatory, and investigatory agencies may be passed on to gaming entities in the form of fees.

1.36 Publicly held gaming entities are generally subject to requirements of federal securities laws, including the Securities Act of 1933 and the Securities Exchange Act of 1934 (the 1934 Act). Entities whose securities are registered under the 1934 Act must comply with its reporting requirements through periodic filings with the Securities and Exchange Commission.

1.37 Provisions of many other federal and state laws affect the operation of gaming operators, such as the following:

- In 1984, the New Jersey Casino Reinvestment Development Authority (CRDA) was created. The purpose of CRDA is to maintain public confidence in the gaming industry by directly facilitating the redevelopment of Atlantic County as well as assessing and addressing the pressing social and economic needs of its residents. (See appendix C, "The New Jersey Casino Reinvestment Development Authority," of this guide for additional details.)
- Under IGRA, net revenues from Class II or Class III gaming, as defined by IGRA, may be used to make per capita payments to members of the tribe only when certain conditions are met.
- To deter and prevent criminal activity, especially *money laundering*, regulations promulgated under the authority of the Bank Secrecy Act of 1970 (BSA) and the USA Patriot Act of 2001 were enacted. For additional guidance concerning this and other acts, refer to appendix D, "Currency Transaction Reporting in the Gaming Industry." Gaming entities are considered financial institutions and must comply with BSA requirements.
- Gaming entities are subject to various laws, regulations, and other requirements related to the privacy of customer information. Many states have passed laws requiring notice to state residents if their personal information has been compromised. In addition, gaming entities processing credit card transactions may be subject to additional protection requirements regarding the personal information of a credit card issuer's customer.

Brief Descriptions of the Games

1.38 The jurisdiction where the gaming entity is located determines the types of games of chance that the gaming entity may operate. The following are brief descriptions of the games most likely to be found in a gaming entity. More detailed descriptions of some of these games are included in appendix E.

Table Games

1.39 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 gaming entity's *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* and *boxpersons*. The most common table games are as follows:

- Craps
- Blackjack, or Twenty-One
- Roulette
- Wheel of Fortune, or Big Six
- Baccarat

Card Games

1.40 Card games, such as *poker* and *panguingui* (*pan*), differ from table games in that the customers wager against each other rather than against the gaming entity's bankroll. 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.

Slot Machines

1.41 *Slot machines* are devices 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 many variations exist. These devices may also be machines that simulate other games, such as poker or blackjack, on a video screen. In addition, gaming equipment manufacturers have offered *wide area progressive* systems to gaming entities. These systems provide the gaming entity with the ability to provide significantly larger jackpot offerings and, at the same time, reduce the gaming entity's risk for funding the jackpot. Typically, the progressive amount increases as a function of each coin played in any machine linked to the system among the participating gaming facilities. The industry is rapidly changing to coinless slot machines. Customers use currency and play the machine against credits representing the amount of the currency placed in the machine. This credit, which is displayed prominently on the face of the machine, goes up or down as the customer wins and loses their wagers. At the completion of playing, the customer redeems their credits for a wagering voucher, commonly referred to as a *ticket*. This ticket can be reintroduced to any machine at that gaming entity equipped with this technology or redeemed with a cashier or at a *redemption kiosk*. This cashless wagering process is commonly referred to as *ticket in, ticket out*, or TITO.

1.42 Conventional slot machines operate independently from other slot machines and contain control programs that determine the outcome of each wager. Technological advances are allowing slot machines to interface with server based gaming systems whereby game outcomes are determined by the system (*system based games*) or control programs within the slot machines, which can be changed from the system (*system supported games*).

Keno

1.43 A keno ticket bears a selection of numbers from 1 to 80. These numbers correspond to 80 numbered Ping-Pong-like balls contained in a special holding unit. Generally, 20 balls are then drawn randomly, and winning wagers are determined by how many numbers on the customer's ticket match those drawn.

Bingo

1.44 A bingo ticket has 5 rows of 5 numbers each, a total of 25 numbers. As numbers are selected at random by the gaming entity, the players cover any corresponding numbers on their cards. The first customer to cover a specified row, column, or design is the winner.

Race and Sports Betting

1.45 Race and sports books are operations in which the player places a bet on the outcome of an animal race or sporting event.

Chapter 2

Guide Scope and Applicability

2.01 Most of the accounting and financial reporting practices of entities undertaking gaming or gaming related activities (collectively referred to as gaming entities) are essentially the same as those of other industries. This Audit and Accounting Guide (guide) addresses accounting, auditing, and financial reporting issues unique to gaming entities. This guide applies to entities traditionally considered gaming entities, such as casinos, and to other entities to the extent that such entities undertake gaming or gaming related activities.

2.02 Financial statements of gaming entities should be prepared in conformity with generally accepted accounting principles (GAAP). For nongovernmental entities, U.S. GAAP is established by Financial Accounting Standards Board *Accounting Standards Codification* 105, *Generally Accepted Accounting Principles*. For governmental entities, GAAP is established by Governmental Accounting Standards Board Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.¹

2.03 Gaming in the United States is conducted by commercially owned entities and by state, local, and tribal governments and their enterprises. The AICPA Audit and Accounting Guide *State and Local Governments* specifies criteria for classifying entities as governmental.² Under those criteria, gaming entities operated by state, local, and tribal³ governments are typically governmental because the sponsoring government has the ability to unilaterally dissolve the gaming entity with the net assets reverting to the sponsoring government; however, other criteria specified in the AICPA Audit and Accounting Guide *State and Local Governments* may also apply.⁴

2.04 Gaming entities subject to the governmental GAAP hierarchy are referred to as *governmental* throughout this guide. Such entities should refer to chapter 12, "Governmental Gaming Entities," of this guide for additional guidance specific to governmental entities.

¹ Readers may consider referring to the auditor's report section of this guide for a discussion regarding issuers' reporting requirements.

² See criteria in paragraph 1.01 of the AICPA Audit and Accounting Guide *State and Local Governments*.

³ Federally recognized tribes (including federally recognized Alaskan native villages and corporations) meet these criteria and are governmental because each has the power to enact and enforce a tax levy, which is one of the criteria for being considered governmental. Also, federally recognized tribes can issue debt bearing interest that is exempt from federal taxation when the debt proceeds are used for essential governmental functions.

⁴ See footnote 2.

Chapter 3

Overview of Gaming and Gaming Related Revenue

Introduction

3.01 Gaming includes activities in which a gaming entity participates in games of chance with customers, with both the gaming entity and the customer having the chance to win or lose money or other items of economic value based on the outcome of the game (commonly referred to as *banked games*¹). Such activities are referred to as *gaming activities*. Examples of games that typically are played as banked games include, but are not limited to, table games, slot machines, keno, bingo, and sports and non-pari-mutuel race betting.

3.02 Games in which the customer has the chance to win or lose money or other items of economic value, with the gaming entity receiving a fee (typically either a fixed fee or a percentage of play) for administering the game, rather than the gaming entity being at risk to win or lose based on the outcome of the game, are neither banked games nor gaming activities. Such activities are referred to as *gaming related activities*. Examples of games that typically are played as gaming related activities include, but are not limited to, card games, certain tournaments, lotteries, and pari-mutuel race betting. Certain games may be either gaming activities or gaming related activities, depending on the facts and circumstances. For example, gaming activities games include play as part of tournaments in which customers play with real money or equivalents, and the entity is at risk to win or lose based on the outcome of the game. Accordingly, for a slot tournament in which customers play with real money and retain any payouts from machines during the tournament, the slot play is a *gaming activity*, whereas the other tournament activities, such as entry fees and prize payouts based on overall standing among tournament entrants, are gaming related activities. Conversely, for a slot tournament in which customers play with credits or other designated machine input other than cash and cash equivalents and accumulate points that determine their standing in the tournament, but retain no cash or other items of economic value as payouts from the machine, the slot play is not a banked game and, therefore, not a gaming activity.

3.03 For some gaming related activities, the entity may have the chance to win or lose money or other items of economic value based on factors other than the outcome of the game, such as business risk (see paragraph 3.12 for an example of this business risk).

3.04 For some activities, the entity has neither business risk nor gaming risk and has no opportunity to make a profit directly from tournament play. A casino may hold a tournament with no banked games, no entry fee, and prizes that are not directly funded by tournament members. For example, the winner of a tournament with no entry fee and no banked games may receive a cash prize or an automobile. Such activities are neither gaming activities nor gaming related activities.

¹ Terms that appear in the glossary are shown in *italics* the first time they appear.

3.05 As explained in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 924-605-25-1, casino revenue shall be 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.

3.06 State lotteries use the net presentation described in paragraph 3.05 for video terminal lottery revenue, but typically report lotto and instant game ticket sales as revenue, with prize payouts reported separately as expenses or as deductions from revenue. Reporting state ticket sales and prize payouts separately reflects a government's responsibility to be accountable to its citizens. The remaining revenue discussion in this chapter does not apply to lotteries. For additional lottery discussion, refer to chapter 12, "Governmental Gaming Entities."

3.07 *Gross gaming revenue*,² or win, is the difference between gaming wins and losses from banked games before deducting incentives or adjusting for changes in progressive jackpot liability accruals. For table games, gross gaming revenue is computed in accordance with the formula in paragraph 3.19. For slot machines, gross gaming revenue is computed in accordance with the formula in paragraph 3.28.

3.08 Gross gaming revenue is typically computed by shift (table games and slots), area (table games), machine (slots), or other aggregate unit. Gross gaming revenue is not computed by each hand, turn, or other individual unit.

3.09 *Net gaming revenue* equals gross gaming revenue (a) minus incentives that are charged to gaming revenue pursuant to paragraphs 3.33–40, (b) plus or minus the change in accrued jackpot liabilities, and (c) plus revenue from gaming related activities.

3.10 Gaming entities generally report all payouts and prizes related to banked games as a component of net gaming revenue. Accordingly, prizes or payouts resulting from banked games, even if not built into a payout table, should not be reported as marketing or promotional expense. For example, customers hitting a particular slot machine combination within a specified time period may win an automobile in addition to the stated jackpot for the particular combination. The cost of that automobile should be reported as a component of net gaming revenue.

3.11 In some circumstances, as discussed in paragraph 3.02, as part of certain gaming related activities, such as tournaments in which the gaming entity is at no risk to win or lose, the gaming entity pays out prizes directly funded by tournament members. For example, tournament members may each pay \$1,000 as an entry fee, with \$950 included in the tournament prize pool and \$50 as a fee to a casino. In such transactions, the prize pool should be reported as a component of net gaming revenue and the fee to the casino included in net gaming revenue.

3.12 In some circumstances, as discussed in paragraph 3.03, as part of certain gaming related activities, the gaming entity has no gaming risk but has business risk. For example, a slot tournament may include no banked games

² Gross gaming revenue is generally not reported by gaming entities in their external financial statements; rather, net gaming revenue is generally reported. Gaming entities generally report gross gaming revenue for internal reporting purposes.

and have a grand prize of \$100,000, regardless of the fees collected from the number of entrants. In this example, the entity may have the chance to win or lose money, and the gaming entity's net profit or loss from such activities should be reported as a component of net gaming revenue.

3.13 In some circumstances, as discussed in paragraph 3.04, as part of certain activities, the gaming entity has no opportunity or intention of making a profit directly from tournament play. For example, a casino may sponsor a tournament with no banked games, no entry fee, and prizes that are not directly funded by tournament members. For example, the winner of a tournament with no entry fee and no banked games may receive a \$100,000 cash prize (or an automobile). Such activities are neither gaming activities nor gaming related activities. Prizes from these types of activities are typically reported as marketing or promotional expense, rather than as a component of net gaming revenue.

Overview of Transactions in the Casino and the Casino Cage

Overview of Table Game Transactions

3.14 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* (the starting 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 the player is playing with cash, the cash is immediately placed in the drop box.

3.15 If the customer is playing on credit, they will sign a multipart *marker* in exchange for which the customer receives chips. A portion of this marker is ordinarily deposited in the drop box. The remaining portion of the marker is ultimately transferred to the casino cage, where a *credit slip* is issued to the table issuing the marker, thus, placing the marker in the custody of the casino cage and establishing *accountability* in the cage. Upon completion of play, the customer may take whatever chips they have 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, markers may be repaid at the table.) If the gaming table has excess chips, 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.

3.16 Each gaming table 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 gross gaming revenue. At the change of a shift or the closing of a table, the chips at the table are counted and entered into the *master game report* or *stiff sheet*. When the contents of the drop box are counted, the amount of gross gaming revenue is determined by totaling the amount of cash, markers issued, the credit received for chips returned to the cage, and the table inventory at the

end of the shift, and by deducting the *fills* received from the cage and the table inventory at the beginning of the shift. This calculated amount is referred to as the *table gross gaming revenue*.

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

- A transfer from the casino cage to a gaming table (documented by a fill slip)
- A transfer 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 marker
- Wagering transactions, which result in either an increase or decrease in the table inventory, depending on whether the casino wins or loses the bets placed

3.18 All transactions listed in the preceding paragraph, except wagering transactions, are either recorded on a document (fill slip, credit slip, or marker) or are exchanges (currency for chips).

3.19 Gross gaming revenue is typically determined for each table in each shift as shown in the following illustration:

Cash in the drop box		\$6,000
Markers issued and outstanding		3,000
Total drop		9,000
Plus/minus chip transfers:		
Fills	(\$5,000)	
Credits	1,000	
Net chip transfers		(4,000)
Plus/minus table inventory change		
Beginning table inventory	(\$14,000)	
Ending table inventory	11,000	
Net change in table inventory		(3,000)
Gross gaming revenue (Win)		\$2,000

3.20 The computation of the gross gaming revenue amounts by table, for each shift, is made on the master game report. These results are summarized by game into shift totals and daily totals.

Overview of the Slot Machine Cycle

3.21 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* or *fill cabinet*, 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 to the hopper.

3.22 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 the hopper will occasionally require a slot fill.

3.23 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.

3.24 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*.

3.25 In certain jurisdictions, slot machines no longer accept or pay out in coins. They are equipped with *currency acceptors*, which also accept previously issued wagering vouchers (tickets) and with ticket printers that generate tickets for customers' winnings rather than the payout being made in cash or coins. Tickets generated by machines can either be used at other machines or redeemed at the cage or redemption kiosks.

3.26 Customers can also deposit monies into a *wagering account* and conduct *electronic money transfers* to the slot machine from their accounts. Conversely, wagering credits can also be sent back to the wagering account via an electronic money transfer.

3.27 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 coin-in, handle pulls, drop, coin-out, bill-in, voucher-in, voucher-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. Additionally, recorded drop-meter readings can be compared to the actual drop.

3.28 Gross gaming revenue is normally computed by machine, by denomination, and in total. Slot machine gross gaming revenue is typically computed as follows:

Cash and tickets removed from the currency acceptors	\$2,000
Plus:	
Coins removed from drop buckets	2,000
Electronic money transfers from a wagering account to the machine	1,000
Total drop	\$5,000

(continued)

Less:

Tickets issued by the machine	(1,000)	
Fills	(1,000)	
Hand paid jackpots	(1,000)	
Electronic money transfers from the machine to a wagering account	(1,000)	
Plus or (minus) change in the hopper balance	(200)	
Total deductions before gross gaming revenue		(4,200)
Gross gaming revenue (Win)*		\$800

* Change in hopper loads are typically not aggregated daily, but are considered and adjusted at the applicable reporting date.

3.29 Details of various types of jackpots and the related accounting can be found in chapter 4, "Jackpot Liabilities."

Overview of the Cage and General Ledger Control

3.30 At the end of each shift, the casino cage prepares a reconciliation, accounting for all the 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, markers, 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.

3.31 The change in the cage accountability 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 markers, (c) funds transferred to or from bank accounts, and (d) payments to customers as they exchange chips or *tokens* 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 markers under the cage's control fluctuates due to markers received from gaming tables and payments received at the cage. The amount of chips or tokens in the casino's possession changes due to the chips or tokens in the customers' possession (*chip float*).

3.32 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.

Overview of Incentive Programs in the Gaming Industry³

3.33 The gaming industry provides various incentives to induce customers to play, many of which allow gambling to take place without customers being required to use their own funds. For some incentive programs, an obligation

³ For a detailed discussion regarding the accounting for these types of incentive programs, refer to chapter 6, "Loyalty and Incentive Programs."

exists to provide benefits based on a customer's level of play (*nondiscretionary programs*). For other programs, there is discretion in determining the benefits provided, if any (*discretionary programs*). For discretionary programs, no predetermined benefits are established or communicated to the customer (or potential customer). Discretionary programs typically are targeted to either past, current, or potential customers and may or may not be related to the level of play. Characteristics of specific programs that are described in the following text, and the terminology used to describe them, may vary. From a financial reporting perspective, the key characteristics are as follows:

- Whether the incentive is discretionary or nondiscretionary
- The nature of the benefit (that is, *free play*, cash, or complimentaries)

3.34 Various types of loyalty programs include the following:

- *Slot clubs*. These programs operate similarly to hotel or credit card point loyalty programs. The customer has a card that identifies the customer when they play on slot machines. Customers earn and accumulate points on the card at a specified rate based on the amount played. For example, every \$1 played earns 10 points. Typically, each point has a value denominated in cash—for example, a point may be worth of \$0.01—and can be exchanged for either (a) cash only, (b) complimentaries, (c) free play, or (d) a combination of all of the above. Points generally can be redeemed at the customer's request, subject to availability, with few "blackout" days.
- *Players clubs*. These programs are similar to slot club loyalty programs, except that customers earn and accumulate points for playing on table games or other games in addition to playing on slots.
- *Club status (also referred to as player tracking)*. In these programs, customers earn a club status, such as a Gold, Silver, or Platinum Member rather than points. Typically, members may be eligible, subject to availability or current policy, for future complimentaries or promotions, or benefits such as preferred check-in.

3.35 Slot management and marketing systems exist whereby customers or potential customers are provided free wagering credits to be used for slot machine play. In addition, credits may be delivered in several other forms. Coupons may be sent to the potential customer, who can redeem them by either having the credits downloaded to the player's club card or by inserting the coupon into the machine directly. The gaming entity may deliver a separate, one-use card to the potential customer. Alternatively, credits can be downloaded directly onto a player's club card while playing as a bonus incentive, which would be considered a loyalty program. In any case, the credits cannot be converted directly to cash, though customers can play with the credits and can redeem any resulting wins for cash net of the gaming entity's win.

3.36 The most typical incentive arrangement is the distribution of match play coupons, typically redeemable for 1 bet. The coupons may be distributed in a variety of ways, including but not limited to mail, a booth in the gaming entity, a newspaper coupon book, and included in packets given to bus customers or

guests checking into hotels. For coupons that are mailed, the gaming entity typically selects the recipients based on their play and estimated value to them. Efforts may also be aimed at broader segments of the population, such as vacationers coming to town. Occasionally, the gaming entity sells 2-for-1 coupons or chips. The coupons typically expire after a specified period (typically, approximately 45 days from distribution).

3.37 An example of a typical match play arrangement is as follows: a customer may bet \$5 cash on a blackjack bet and use the coupon to match the bet, thereby getting credit for a \$10 bet. These customers may or may not be members of other customer loyalty programs. (These coupons are similar to the cash coupons discussed in paragraph 3.38, except that for coupons considered "match play coupons" for purposes of this guide, customers must play with all benefits they accept, rather than retain cash without playing.)

3.38 Gaming entities have used cash coupons or other cash incentives (commonly referred to as *straight cash incentives*) for many years. In the 2 most typical arrangements, they either (a) give cash directly to a potential customer, or (b) send a coupon to a potential customer, who can redeem the coupon for cash at the gaming entity. The coupons usually expire after a specified period (typically, approximately 45 days from mailing.) In either case, no guarantee exists that the potential customer will play the cash. In other words, the potential customer may receive the cash and choose not to play with it. (These coupons are similar to the match play coupons discussed in paragraph 3.37, except that customers may choose not to play with cash they accept through cash coupons.) Usually, the gaming entity is able to determine which potential customers play with the cash and which do not. Typically, an immaterial percentage of potential customers choose not to play with the cash.

3.39 Premium customers often receive free, noncashable *promotional chips*, often in a high denomination (say \$10,000), which can be used for table games wagers. This program is a form of free play and is similar to the free play program previously discussed. Promotional chips are typically awarded based on credit lines, which are a proxy for amounts expected to be played.

3.40 Certain premium customers receive offers whereby, if they lose, they will receive a discount on their credit balance. (For example, some casinos extend credit to customers in exchange for playing chips. The discount on credit balances is based on the outstanding balance at the end of the customer's visit.) These discounts are typically prearranged in exchange for the customer agreeing to play for a certain volume of activity. Such discounts on credit balances are akin to credits that an entity can apply against trade amounts owed to a vendor.

3.41 When accounting for promotional allowances, FASB ASC 924-605-45-1 states that 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. Additionally, FASB ASC 924-720-25-1 explains that the cost of providing promotional allowances shall be included in costs and expenses.

3.42 As explained in FASB ASC 924-605-45-2, the retail amount of promotional allowances shall not be included in gross revenue and charged to

operating expenses because that would overstate both revenues and expenses. 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.

Chapter 4

Jackpot Liabilities

Applicability: This chapter provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.

Background

4.01 Slot machines are games of chance in which both the gaming entity and the customer have the chance to win or lose based on the outcome of the game. In addition, slot machine *jackpots*¹ are controlled by the gaming entity over the long-term and are typically programmed to provide a specified *hold percentage* to the gaming entity. Within that framework, and based on the normal *reel cycle* of the slot machine, jackpots are expected to be won by the customer. An issue arises about whether such jackpots should be accrued for in advance of the jackpot occurring.

Summary of Selected Accounting Literature

4.02 Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 924, *Entertainment—Casinos*^{*} includes the primary accounting relating to jackpot liabilities.

Types of Jackpots for Purposes of Accounting for Jackpot Liabilities

4.03 Jackpots can generally be categorized among four basic types: single machine *progressive jackpots*, single machine *nonprogressive jackpots*, *local area progressive jackpots*, and *wide area progressive (WAP) jackpots*. The *base progressive amount* of any of the progressive jackpots is referred to as the *base progressive jackpot*. Both the single machine nonprogressive jackpots and the based progressive jackpots are referred to as *base jackpots*. Appendix E, "Rules of the Game," contains additional information about the operational aspects of these jackpots.

4.04 In most gaming jurisdictions, gaming entities are not required (in advance until the jackpot is won) to award any nonprogressive jackpot, whether

¹ Terms that appear in the glossary are shown in *italics* the first time they appear.

^{*} On December 17, 2009, the Financial Accounting Standards Board issued proposed Accounting Standards Update No. 2010-16, *Entertainment—Casino (Topic 924): Casino Base Jackpot Liabilities—a consensus of the FASB Emerging Issues Task*. The proposed guidance was issued to eliminate diversity in practice for entities not already following this guidance and will be effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2010. The guidance is to be applied prospectively with a cumulative-effect adjustment reflected in retained earnings.

the jackpot is won during the normal reel cycle or not. Rather, gaming regulators require slot machines to operate within their preapproved payout percentage tolerances programmed into the machine.

4.05 For single machine progressive jackpots and local area progressive jackpots, in most gaming jurisdictions, gaming entities are required (by law or regulation) to award the *incremental progressive amount* whether the jackpot is won during the normal reel cycle or not. This requirement is based on the principle that the incremental amount was funded by the customers and, therefore, must be returned to them. If the gaming entity desires to remove the *progressive slot machine* or the *progressive system* from the floor before the progressive jackpot has been won, gaming regulations typically allow the gaming entity to award the incremental progressive amount in another form, such as a one-time prize drawing. The base progressive amount is funded by the gaming entity. Although not common, some gaming jurisdictions also require the gaming entity to award the base progressive amount, whether the jackpot is won during the normal reel cycle or not. As stated previously, most gaming jurisdictions require only the incremental amount to be awarded.

4.06 *Wide area progressive systems* can be operated by a gaming entity at several of its own locations or can be operated by a third party, such as a gaming manufacturer, at multiple gaming entities' locations. In those cases, the WAP operator typically charges gaming entities a fee for providing the progressive system and awarding the progressive jackpots. From the customer's perspective, wide area progressive slot machines operate identically to local area progressive slot machines, with the base progressive amount and incremental progressive amount. For accounting and financial reporting purposes, a gaming entity with multiple locations that offers a linked progressive system at many of its other locations would follow the accounting described in the following text for local area progressive jackpots, not WAP jackpots.

4.07 In most gaming jurisdictions, WAP operators are required to award the incremental progressive amount of the WAP jackpot, whether the jackpot is won or not. Generally, gaming entities may remove slot machines from the WAP system. However, if the WAP operator desires to remove all the WAP progressive machines from all locations (a system shutdown) before the progressive jackpot has been won; gaming regulations typically require the WAP operator to transfer the incremental progressive amount to another WAP system. Jurisdictions differ on the treatment of the base progressive amount. Usually, the initial base progressive amount is funded by the WAP operator. Subsequent base amounts may be funded by the WAP operator or from fees received from the gaming entities. Some jurisdictions allow the WAP operator to recover their contribution to the base amount. Upon system shutdown, some gaming jurisdictions require the WAP operator to transfer the base progressive amount to another WAP system, whereas other jurisdictions do not.

Accounting for Jackpots

4.08 An entity shall not accrue a base jackpot if payment of the jackpot can be avoided. An entity shall charge a base jackpot to revenue at the time the entity has the obligation to pay the jackpot.

4.09 For the incremental progressive amount, which is based on past play, the Financial Reporting Executive Committee (FinREC, formerly the Accounting Standards Executive Committee) believes an accrual should be

recorded over the time period in which the incremental progressive jackpot amount is generated, and the accrual should be calculated based on the level of customer play. FinREC believes the offsetting debit should be one of the deductions to arrive at net gaming revenue.

4.10 WAP jackpots are the responsibility of the WAP operator, not the gaming entity. For those jackpots, FinREC believes the WAP operator should follow the accounting in the preceding paragraphs 4.08–.09 for the base progressive amounts and the incremental progressive amounts. In addition, WAP operators' record accruals for funds received from gaming entities related to funding of the base progressive amounts in accordance with gaming regulations and the WAP operators' contracts with gaming entities. Such accruals should be recognized as funds are received from the gaming entities. The revenues recorded by the WAP operator for fees charged to gaming entities should be recognized as gross revenues in accordance with FASB ASC 605-45, as explained in FASB ASC 650, *Revenue Recognition*. The offsetting debit for recording jackpots and other liabilities should be recorded as a component of cost of sales. This differs from a gaming entity's treatment of the offsetting debit under the basic gaming revenue model because of the difference in the nature of transactions between (a) a WAP operator and a gaming entity, and (b) a gaming entity and its customers. Winners of certain WAP jackpots have the option to receive their winnings in periodic installments over time or as a one-time distribution equal to the present value of those future payments. The present value of the future payments should be used to determine the liability.

Chapter 5

Participation and Similar Arrangements

Applicability: This chapter provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.

Background

5.01 Gaming entities periodically enter into *participation arrangements*¹ with gaming suppliers. In participation arrangements, the title to the slot machine is typically retained by an owner/seller,² such as the manufacturer of a machine. The agreements between the gaming entity and the owner/seller stipulate that the entity and the owner/seller share (participate) in the gaming activity by sharing either the *win* or by the gaming entity paying a fixed percentage of *coin in* or a flat fee to the owner/seller.

5.02 Gaming entities periodically enter into *third party licensing* arrangements with the owner/seller of a copyrighted game or other intellectual property. Title to the intangible asset (the copyrighted game or intellectual property) is typically retained by the owner/seller, who receives a flat fee per specified time period or percentage of coin in or net gaming win. Such arrangements may be day-to-day, month-to-month, or for periods exceeding 12 months.

5.03 From the perspective of a gaming entity, *wide area progressive* (WAP) *arrangements* function in a manner similar to participation arrangements but are not participation arrangements. In WAP arrangements, the fees paid by the entity to the third party administrator primarily relate to the services provided to maintain and operate a wide area progressive system, including the WAP jackpot.

Summary of Selected Accounting Literature

5.04 The primary accounting guidance relating to participation and similar arrangements is described in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 840, *Leases*, and more specifically, FASB ASC 840-10-15 provides guidance for determining whether an arrangement is a lease. FASB ASC 605-45 explains the guidance in FASB ASC 605, *Revenue Recognition* when determining principal and agent considerations

¹ Terms that appear in the glossary are shown in *italics* the first time they appear.

² This document uses the term *owner/seller* to refer to the party providing the machine. In practice, the manufacturer is typically the owner/seller of the machine or the copyright or license right holder (for intellectual property or license rights pertaining to games). The owner/seller may, however, be a party that purchased a machine from an owner/seller or the copyright or license right holder.

for the reporting of revenue and for entities subject to regulation by the Securities and Exchange Commission (SEC), SEC *Codification of Staff Accounting Bulletins*, topic 13, "Revenue Recognition." In addition, when applicable, FASB ASC 985, *Software*, should also be considered.*

Analysis of Lease Criteria for Various Pricing Arrangements

5.05 To determine whether the arrangement should be accounted for as a lease under FASB ASC 840, an analysis of the specific terms of each contract governing a participation, third party license, or WAP arrangement should be

* In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*, to significantly improve the accounting and reporting of transactions involving multiple-deliverable arrangements to more closely reflect the underlying economics of transactions. ASU No. 2009-13 amends FASB ASC 605-25 to

1. require separating consideration in multiple-deliverable arrangements in more circumstances than under existing generally accepted accounting principles.
2. establish a selling-price hierarchy for determining the selling price of a deliverable.
3. replace the term *fair value* in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant.
4. eliminate the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method.
5. require that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis.
6. significantly expand the disclosures related to a vendor's multiple-deliverable revenue arrangements.

ASU No. 2009-13 should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless the vendor elects to adopt the pending content in this ASU on a retroactive basis in accordance with FASB ASC 605-25-65-1(e). Early application is permitted. See FASB ASC 605-25-65-1 for specific disclosure requirements related to early application and adoption year disclosure requirements.

Also, in October 2009, FASB issued ASU No. 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements—a consensus of the FASB Emerging Issues Task Force*, to significantly improve the accounting and reporting of transactions involving revenue arrangements that contain tangible products and software to more closely reflect the underlying economics of transactions. The amendments in ASU No. 2009-14

- a. changes the accounting model for revenue arrangements that include both tangible products and software elements.
- b. requires that hardware components of a tangible product containing software components always be excluded from the software revenue guidance.
- c. provides additional guidance on
 - i. how to determine which software, if any, relating to the tangible product also would be excluded from the scope of the software revenue guidance.
 - ii. how a vendor should allocate arrangement consideration to deliverables in an arrangement that includes both tangible products and software.
 - iii. how to allocate arrangement consideration when an arrangement includes deliverables both included and excluded from the scope of the software revenue recognition guidance.

ASU No. 2009-14 should be applied prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. If a vendor elects early adoption and the period of adoption is not the beginning of a vendor's fiscal year, the vendor is required to apply this ASU retrospectively from the beginning of its fiscal year. A vendor may also elect, but is not required, to adopt this ASU retrospectively to prior periods, with certain exceptions. See FASB *Accounting Standards Codification* 985-605-65-1 for specific disclosure requirements related to early application and adoption year disclosure requirements.

performed by each party to the arrangement using the guidance explained in FASB ASC 840-10-15.

Conclusions and Income Statement Presentation

5.06 Participation arrangements are typically leases. Typically, gaming entities would report these arrangements as operating leases because none of the criteria set forth in FASB ASC 840-10-25-1 have been met. Accordingly, the income statement classification of the fees paid pursuant to these arrangements should be an expense rather than a contra revenue.

5.07 FASB ASC 924-605-25-3 explains that 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.

5.08 Third party license arrangements are typically not leases. The fees paid pursuant to these arrangements should be reported as an expense, that is, the arrangement should be reported "gross" in accordance with FASB ASC 605-45.

5.09 If a WAP arrangement is not a lease,³ gaming entities should report fees paid to the owner/seller pursuant to a WAP arrangement as contra revenue consistent with the gaming entities' treatment of jackpots paid and payments for jackpot insurance. As described in chapter 4, "Jackpot Liabilities," owners/sellers should recognize revenue for the fees charged to gaming entities and recognize expenses for the jackpots it pays.

³ If a wide area progressive arrangement is determined to be a lease, income statement presentation and disclosure information would be consistent with the guidance in paragraph 5.06 for participation agreements that are determined to be leases for accounting purposes.

Chapter 6

Loyalty and Incentive Programs

Applicability: This chapter provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.

Summary of Selected Accounting Literature

6.01 The Financial Accounting Standards Board (FASB), Financial Reporting Executive Committee (FinREC, formerly the Accounting Standards Executive Committee), and the FASB Emerging Issues Task Force, previously considered, but reached no consensus, on the broad issue of reporting loyalty and incentive transactions described in chapter 3, "Overview of Gaming and Gaming Related Revenue," of this guide.¹ FASB *Accounting Standards Codification* (ASC) 605-50 explains the guidance in FASB ASC 605, *Revenue Recognition*, regarding customer payments and incentives and provides guidance that is applicable to some of these incentive programs and activities, but diversity in practice in the gaming industry exists in applying some of that guidance. In addition to FASB ASC 605-50, readers may also consider referring to the guidance explained in FASB ASC 450, *Contingencies*, with an emphasis on the guidance contained in FASB ASC 450-20-25 for the recognition of loss contingencies; Securities and Exchange Commission *Codification of Staff Accounting Bulletins* topic 13, "Revenue Recognition," and topic 13.A.3, "Delivery and Performance;" and paragraphs 35–36 of FASB Concept No. 6, *Elements of Financial Statements*.

General Description of, and Accounting for, Loyalty and Incentive Programs

6.02 The various forms of incentive programs offered by gaming entities are described in paragraphs 3.33–.40 of this guide. Those incentives can generally be considered *discretionary*² or *nondiscretionary* (terms discussed further in the following text) for purposes of determining the proper accounting for each form of incentive.

Discretionary Incentive Programs

6.03 Discretionary incentives are offered to customers either (a) based on past levels of play or (b) to induce future play. In either case, prior to the

¹ The Financial Accounting Standards Board (FASB) currently has a revenue recognition project that will begin to address this issue. Readers are advised to monitor the project's progress. For additional information, refer to FASB's website at www.fasb.org.

² Terms that appear in the glossary are shown in *italics* the first time they appear.

incentive being offered to the customer, there is no obligation on the part of the gaming entity to provide the incentive through a loyalty program or otherwise.

6.04 Incentives offered in advance of the related revenue are offered to induce customers to achieve some desired level of gaming activity. In determining to whom and in what amount to offer discretionary incentives, gaming entities typically use information about past gaming transactions. Though such incentives are offered based on past play, the discretionary incentives are, nevertheless, given to induce current or future play, rather than as an obligation based on past play.

6.05 Discretionary incentives are typically considered part of the normal marketing activities of the gaming entity. For example, offers such as free play, cash, or cash equivalents (including discounts on credit balances), complimentary, or other benefits offered to potential customers are generally made with the expectation of related revenue transactions and may be conditioned on the potential customer agreeing to play a certain dollar amount during a specified future period.

6.06 In circumstances in which the incentive relates to a future revenue transaction, FASB ASC 605-50-25-3 provides guidance in recognizing the "cost" of the incentive at the later of the following events:

- The date at which the related revenue is recognized by the vendor
- The date at which the sales incentive is offered (which would be the case when the sales incentive offer is made after the vendor has recognized revenue; for example, when a manufacturer issues coupons offering discounts on a product that it already has sold to retailers)

6.07 In gaming, discretionary incentives may be offered in advance of earning the related gaming revenue (such as in an offer mailed to potential customers) or after the related revenue (such as a complimentary meal offered to a customer after several hours of playing slot machines). Therefore, in any case, the incentive is recognized at the time the related revenue is recognized because either (a) the revenue is the later of the two events, or (b) the offer is the later of the two transactions but is offered immediately after the revenue is recognized. Viewed another way, no "cost" of the incentive exists without the related revenue events. The cost of such incentives is typically charged as an expense to the department which they benefit.

6.08 Accounting for various forms of specific incentives offered on a discretionary basis is described in paragraphs 6.13–.16 of this guide.

Nondiscretionary Incentive Programs

6.09 Nondiscretionary incentive programs offer incentives based on past gaming activity. The primary form of nondiscretionary incentive programs is a point-based loyalty program, in which customers earn points as they play and can redeem those points for something of value, whether cash, free play, or other incentives, such as complimentary.

6.10 For nondiscretionary incentive programs, FinREC believes it is acceptable practice to report these programs using either (a) a deferred revenue model or (b) an immediate revenue/cost accrual model. FinREC believes the deferred revenue model is appropriate in all circumstances, whereas the immediate revenue/cost accrual model is acceptable in only certain circumstances.

For example, FinREC believes an immediate revenue/cost accrual model is inappropriate in circumstances in which (a) a significant number of paying customers are displaced by customers redeeming awards,³ or (b) the value of an individual award is significant compared with the purchase earning the award.

6.11 Under a deferred revenue model,⁴ a portion of the revenue from the original transaction is attributed to the incentive based on a relative fair value allocation, and the deferred portion of the revenue is recognized when the incentive is redeemed. Accounting for various forms of specific incentives offered on a nondiscretionary basis is described in paragraphs 6.17–.26 of this guide.

6.12 Under an immediate revenue/cost accrual model, costs are typically measured using an incremental cost model. The incremental cost for points that can be redeemed for cash is the full cash value. The gaming entity will have to use judgment to determine the incremental cost to be assigned to other incentives earned. In connection with such programs, gaming entities accrue a liability as points are earned under such programs, based on the relative value of each point earned. Amounts accrued may reflect expected *breakage* as defined in the FASB ASC glossary, if the requirements of FASB ASC 605-50 are met.⁵

Specific Accounting for Various Discretionary Incentives

Free Play Offered Other Than Through Loyalty Programs

6.13 The economic effect of free play is to provide cashable benefits that increase the customer's odds of winning, changing the basic odds of the game. Furthermore, the use of free play will not trigger accounting recognition because revenue is measured based on an aggregate daily (or shift) basis, rather than on a per bet or per customer basis. Because revenue is the net win from gaming activities, the use of the benefit has no effect on the reporting of net win or loss from gaming activities. For example, if a customer bets \$5 of his or her own cash and wins \$1, the gaming entity reports revenue of \$4. If a customer bets \$5 of his or her own cash, uses \$5 of credits from his or her club card, and wins \$1, the gaming entity reports revenue of \$4. In each transaction, the net win is \$4, but the hold percentages are different in the two transactions. Also, pursuant to FASB ASC 605-50-45-2, cash consideration given as a sales incentive is presumed to be a reduction in selling price.

³ For purposes of applying the guidance in this guide, the fact that a customer redeeming an award might otherwise have been a paying customer had they not redeemed the award should not lead to the conclusion that a paying customer has been displaced by a customer redeeming an award. In other words, a customer redeeming an award does not displace themselves as a paying customer for purposes of applying the guidance in this guide.

⁴ See FASB *Accounting Standards Codification* 605-50-25-4 for a discussion regarding the recognition of a liability (or *deferred revenue*).

⁵ Expected breakage represents the portion of calculated customer benefits earned (or portions thereof) that the entity estimates will not be redeemed. It includes expected breakage for amounts transferred to customers and not redeemed, as well as expected breakage for points that will not be redeemed because customers have not reached specified thresholds. If the entity cannot reasonably estimate amounts that will be claimed, measurement should be based on the maximum amount that may be claimed.

Cash or Cash Equivalents Offered Other Than Through Loyalty Programs

6.14 As discussed in paragraph 6.07, discretionary incentives are recognized at the date at which the related gaming revenue is recognized. For example, assume a gaming entity offers a customer a 10 percent discount on his or her losses if the customer meets certain criteria. Further, assume the customer meets the criteria and his or her play results in \$1 million of gaming win for the gaming entity (before the 10 percent discount) and a related marker due from the customer. The revenue (and the related receivable) should be reduced to \$900,000 to reflect the 10 percent discount because pursuant to FASB ASC 605-50-45-2, cash consideration given as a sales incentive is presumed to be a reduction in selling price.

6.15 In some circumstances, cash is offered to customers as a marketing incentive. As an example, customers, as part of bus trips to casinos, may be entitled to a roll of coins, with an aim toward having the customers enter the casino and play slot machines with those coins. Some customers, however, choose not to play and simply retain those coins. Such incentive programs are aimed at generating incremental gaming revenue from the customer group in aggregate, rather than by an individual customer. Given that purpose, and the fact that nonusage of the coins is insignificant, the cost of the incentive should be netted against revenue.

Complimentaries Offered Other Than Through Loyalty Programs

6.16 Pursuant to FASB ASC 605-50-45-3, noncash consideration given as a sales incentive should be reported as an expense, rather than a reduction of revenue. Accordingly, discretionary complimentaries are typically reported as expenses. Expenses for complimentaries are typically reported at cost (no revenue should be reported as a result of providing complimentaries).

Specific Accounting for Various Nondiscretionary Incentives

Free Play Offered Through Nondiscretionary Loyalty Programs

6.17 As discussed in paragraph 6.13, the economic effect of free play is to provide cashable benefits that increase the customer's odds of winning. Pursuant to FASB ASC 605-50-25-7 through 605-50-25-9, a cost and liability for amounts owed as free play under nondiscretionary loyalty programs should be accrued. The basis for concluding that the gaming entity should report a liability for amounts owed as free play is that to the extent that a customer is entitled to free play, the gaming entity has a present obligation to transfer economic benefits to the customer, with the economic benefit being the estimated amount the customer will win by exercising the free play. If a customer earns free play (or points that can be redeemed for free play) based on the level of play, the gaming entity should accrue a liability for cash that it expects to pay (as a result of customers redeeming the free play or redeeming the points), as the points are earned. The liability should be measured based on the expected payout percentage, net of expected breakage, based on the amount of free play owed based upon the minimum play required to convert the free play to a cash payout. In measuring the liability, gaming entities should not assume play

beyond the free play amount because the customer is only required to play the free play through the machine (or other game) once. Pursuant to FASB ASC 605-50-45-3, FinREC believes that the cost of free play is recorded as contra revenue. FinREC considered whether free play was a deliverable in an exchange transaction and not a rebate or refund of a portion of the amount charged to the customer. FinREC believes free play to be a cashable benefit rather than a deliverable in an exchange transaction because the economic effect of free play is to increase the customer's odds of winning, which is akin to a refund of a portion of the amount charged to the customer (played). Additionally, FinREC believes that offering free play increases the customer's odds of winning cash by providing a payout of economic benefits that are expected to be converted into cash through gaming activity.

6.18 For example, assume that a customer played \$10,000 on a slot machine, received \$9,300 in cash payouts, and earned 10,000 points entitling them to \$100 of free play. Further, assume the gaming entity's average hold percentage is 7 percent. For purposes of simplicity, there is no assumed expected breakage in this example. Under the immediate revenue/cost accrual method, the gaming entity should debit gaming revenue and credit the free play liability for \$93, as the points are earned. Combined with the recognition of the \$700 of gaming revenue in the related transaction, net gaming revenue for the period is \$607. When the customer exercises the free play, the gaming entity should debit the free play liability and credit gaming revenue for \$93. Under this model, in the period of redemption, assuming the customer plays only the \$100 of free play and the gaming entity achieves the average hold percentage of 7 percent, net gaming revenue for the period of redemption would be \$0 (representing a \$93 debit to gaming revenue for the payouts on the \$100 of free play, at a 7 percent hold percentage, offset by the \$93 credit to gaming revenue to eliminate the free play liability).

6.19 Assuming the same facts, under the deferred revenue model as discussed in paragraph 6.11, the gaming entity should defer \$99 of the amounts played based on the following calculation: The two elements of the transaction are the play with a fair value of \$10,000 and the future free play with a fair value of \$100. The deferral percentage is $100/10,100$, or .99 percent. Applied to the \$10,000, this means \$99 of revenue should be deferred. Combined with the recognition of the \$700 of gaming revenue in the related transaction, net gaming revenue for the period is \$601. Under this model, in the period of redemption, assuming the customer plays only the \$100 of free play, and the gaming entity achieves the average hold percentage of 7 percent, net gaming revenue for the period of redemption would be \$6 (representing a \$93 debit to gaming revenue for the payouts on the \$100 of free play, at a 7 percent hold percentage, offset by the \$99 credit to gaming revenue to record the deferred gaming revenue).

Cash or Cash Equivalents Offered Through Nondiscretionary Loyalty Programs

6.20 The economic effect of providing cash or cash equivalent benefits based on the level of play is to increase the customer's odds of winning. Pursuant to FASB ASC 605-50-25-7 through 605-50-25-9, a cost and liability for amounts owed as cash or cash equivalent benefits under nondiscretionary loyalty programs should be accrued. The basis for concluding that the gaming entity should report a liability for amounts owed as cash or cash equivalent

benefits is that to the extent a customer is entitled to those cash or cash equivalent benefits, the gaming entity has a present obligation to transfer economic benefits to the customer. The liability should be measured, net of expected breakage,⁶ based on the amount of cash owed, and in measuring the liability; the gaming entity should not assume that the customer will play with that cash. The offset to that liability recognition should be contra revenue, pursuant to FASB ASC 605-50-45-2 because by transferring the right to those cash or cash equivalent benefits, the gaming entity effectively reduced gaming revenue from the bets placed that entitled the customer to the cash or cash equivalent benefits.

6.21 For example, assume a customer played \$10,000 on a slot machine, received \$9,300 in cash payouts, and earned 10,000 points entitling him or her to \$100 of cash back. For purposes of simplicity, there is no assumed breakage in the example. Under either the immediate revenue/cost accrual method or the deferred revenue model, the gaming entity should debit gaming revenue and credit cash benefit liability (under the immediate revenue/cost accrual model) or deferred revenue (under the deferred revenue model) for \$100, as the points are earned. Combined with the recognition of the \$700 of gaming revenue in the related transaction, net gaming revenue for the period is \$600. When the award is redeemed, the gaming entity should debit the cash benefit liability and credit cash.

Complimentaries Offered Through Nondiscretionary Loyalty Programs

6.22 The economic effect of providing complimentaries based on nondiscretionary loyalty programs is similar to a multiple element arrangement. However, the guidance in FASB ASC 605-25 regarding multiple element arrangements explicitly excludes broad based loyalty programs from its scope.* In the absence of authoritative guidance, both the deferred revenue and immediate

⁶ Breakage from nondiscretionary loyalty programs is not typically considered to be abandoned property, and escheat laws are generally inapplicable to such programs.

* In October 2009, FASB issued Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*, to significantly improve the accounting and reporting of transactions involving multiple-deliverable arrangements to more closely reflect the underlying economics of transactions. ASU No. 2009-13 amends FASB ASC 605-25 to

1. require separating consideration in multiple-deliverable arrangements in more circumstances than under existing generally accepted accounting principles.
2. establish a selling-price hierarchy for determining the selling price of a deliverable.
3. replace the term *fair value* in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant.
4. eliminate the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method.
5. require that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis.
6. significantly expand the disclosures related to a vendor's multiple-deliverable revenue arrangements.

ASU No. 2009-13 should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless the vendor elects to adopt the pending content in this ASU on a retroactive basis in accordance with FASB ASC 605-25-65-1(e). Early application is permitted. See FASB ASC 605-25-65-1 for specific disclosure requirements related to early application and adoption year disclosure requirements.

revenue/cost accrual models have been used to account for complimentary offerings through nondiscretionary loyalty programs.

6.23 When the immediate revenue/cost accrual model is used, FinREC believes that costs of complimentary offerings should be accrued when the related revenue is recognized and, pursuant to FASB ASC 605-50-45-3, such amounts should be charged to expense. FinREC's basis for believing that the gaming entity should report a liability for complimentary offerings owed is that to the extent that a customer is entitled to those complimentary offerings, the gaming entity has a present obligation to transfer economic benefits to the customer. The offset to that liability recognition should be an expense, pursuant to FASB ASC 605-50-45-3 because by transferring the right to those complimentary offerings, the entity is providing a free product or service that is a deliverable in an exchange transaction, rather than a refund or rebate of a portion of the amount charged to the customer.

6.24 For example, assume that a customer played \$10,000 on a slot machine, received \$9,300 in cash payouts, and earned 10,000 points entitling them to \$100 of complimentary offerings. Further, assume the gaming entity's average hold percentage is 7 percent. Further assume that the gaming entity determined that the incremental cost of \$100 of complimentary offerings is \$30. For purposes of simplicity, there is no assumed expected breakage in this example. Under the immediate revenue/cost accrual method, the gaming entity should debit gaming expense and credit the complimentary liability for \$30, as the points are earned. Net gaming revenue for the period is \$700. When the customer redeems the complimentary offerings, the gaming entity should debit the loyalty program liability and credit the appropriate revenue source for \$30 (along with recognizing the actual cost of providing the complimentary service).⁷

6.25 Assuming the same facts, under the deferred revenue model, the gaming entity should defer \$99 of the amounts played based on the following calculation: The two elements of the transaction are the play with a fair value of \$10,000 and the future complimentary offerings with a fair value of \$100. The deferral percentage is $100/10,100$, or .99 percent. Applied to the \$10,000, this means \$99 of revenue should be deferred. Combined with the recognition of the \$700 of gaming revenue in the related transaction, net gaming revenue for the period is \$601. Under this model, in the period of redemption, net gaming revenue for the period of redemption would be \$99 (along with recognizing the actual cost of providing the complimentary service).

6.26 The following table summarizes the resulting revenues under the immediate revenue/cost accrual model and the deferred revenue model from the various examples of nondiscretionary incentives presented in paragraphs 6.17–25.

⁷ The revenue and gaming expense are ultimately "eliminated" in the gaming entity's financial statements. As discussed in chapter 4, "Jackpot Liabilities," no revenue should be reported as a result of providing complimentary offerings.

	Immediate Revenue/ Cost Accrual			Deferred Revenue		
	Period 1	Period 2	Total	Period 1	Period 2	Total
Free play	\$607	\$—	\$607	\$601	\$6	\$607
Cash	600	—	600	600	—	600
Complimentaries	700 ⁸	— ⁹	700	601	99 ¹⁰	700

Nondiscretionary Loyalty Programs in Which Customers Have the Option of Choosing Multiple Types of Incentives

6.27 Some gaming entities have nondiscretionary incentive programs that provide customers with a choice of free play, cash, complimentaries, or other economic benefits. In circumstances in which liabilities are recognized in conformity with the guidance in this chapter, those liabilities should be measured based on the amounts and types of benefits the gaming entity expects to provide in circumstances in which the gaming entity can reasonably and reliably estimate such amounts based on its history. In circumstances in which the gaming entity cannot reasonably and reliably estimate such amounts based on its history, the liability should be measured based on a presumption that customers will choose to receive incentives with the highest cost to the gaming entity, taking into consideration expected breakage.¹¹ The cost and redemption of such incentives should be reported based on the type of incentive liability reported.

Incentive Programs That Provide Customers With Designated Status Without Entitling Customers to Any Economic Benefits

6.28 Some gaming entities have incentive programs that provide customers with a designated status without entitling the customers to any cash, complimentaries, or other economic benefits, though that status may lead to complimentaries or other benefits, subject to the approval of management. Such programs generally do not result in an accounting recognition prior to offering such benefits because no obligation exists to transfer resources to customers.

Financial Statement Disclosures

6.29 Generally, policies pertaining to accounting for loyalty and incentive programs are disclosed in accordance with FASB ASC 235-10-50 explained in FASB ASC 235, *Notes to Financial Statements*. Typical information provided by gaming entities include the nature of the programs, whether an immediate

⁸ Also recognize gaming department expense of \$30 for the estimated cost of providing the complimentary goods or services.

⁹ Recognize nongaming revenue of \$30 and the actual cost of providing the complimentary goods or services. The \$30 of nongaming revenue and \$30 of gaming department expense are ultimately "eliminated."

¹⁰ Also recognize the actual cost of providing the complimentary goods or services.

¹¹ Typically, cash incentives have the highest cost to the gaming entity, followed by free play, and then complimentaries, assuming the face amount of the incentives are equal.

revenue/cost accrual model or a deferred revenue model is applied, and how the related liabilities or deferrals are calculated (including the method of determining the cost of complimentary goods and services and whether breakage has been considered).

Chapter 7

Gaming License, Project Development, and Preopening and Start-Up Costs

Applicability: This chapter provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.

Background

7.01 Gaming entities incur a variety of costs prior to opening a new gaming facility. Generally, these types of costs can be classified as follows:

- Costs to obtain a gaming license
- Project development costs
- Preopening and start-up costs

7.02 Accounting for these costs has sometimes been diverse in practice. For instance, gaming entities have applied different policies in determining when to begin capitalization of costs when seeking to obtain a gaming license. Also, the determination of which costs to classify as preopening and start-up expenses has varied among gaming entities. In addition, accounting for certain of these costs can be dependent on the rules and regulations within each gaming jurisdiction. For example, many jurisdictions have license renewal requirements that are essentially perfunctory, so gaming entities have generally concluded that license costs related to these jurisdictions are indefinite lived intangible assets.

Summary of Selected Accounting Literature

7.03 The primary accounting literature relating to gaming license costs is Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 350, *Intangibles—Goodwill and Other*.^{*} The likelihood concepts

^{*} In December 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) No. 2010-28, *Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force)*. The amendments in this update modify step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples in FASB *Accounting Standards Codification* 350-20-35-30, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event

(continued)

referred to in this chapter are similar to those defined in FASB ASC 450, *Contingencies*. The primary literature for preopening and start-up costs is FASB ASC 720-15 as described in FASB ASC 720, *Other Expenses*. Although FASB ASC 970, *Real Estate—General*, specifically excludes real estate developed for an entity's own use from its scope, gaming entities often find certain guidance in FASB ASC 970 helpful by analogy due to the similarity of certain initial costs incurred when constructing a gaming facility and the costs associated with the development of other real estate projects.

Costs to Obtain a Gaming License

7.04 A gaming entity may incur costs in advance of obtaining a gaming license. For instance, a gaming entity may incur legal or other third party costs to determine if a gaming facility is financially feasible in a particular market. Or, a gaming entity may incur lobbying costs or make payments or enter into financial commitments¹ in an effort to obtain approval from the gaming authorities for the gaming license.

7.05 Such costs incurred prior to it being probable that the gaming entity will obtain the license are expensed as incurred. The determination that obtaining a gaming license is probable will require the judgment of the gaming entity. This determination is based on the facts and circumstances of each situation, such as the gaming entity's history in obtaining licenses and the specific jurisdiction's history in granting licenses.

7.06 Once a gaming entity believes that the likelihood of obtaining a gaming license is probable, certain costs incurred by gaming entities are generally capitalized.² These costs are considered part of the cost of the gaming license, an intangible asset.

7.07 Internal costs, overhead, and other costs required to be expensed under existing literature (such as most advertising costs) are expensed as incurred.

7.08 If the gaming license is an asset with a finite life, the costs are amortized over its expected life, typically, the stated term of the license.³ Determining whether a gaming license has an indefinite or finite life frequently requires judgment, including considering the nature of the renewal process and additional economic sacrifices, if any, required when renewing the license.

(footnote continued)

occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, this amendment is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption not permitted. For nonpublic entities, this amendment is effective for fiscal years and interim periods within those years, beginning after December 15, 2011. Nonpublic entities may early adopt the amendment using the effective date for public entities.

¹ Payments or commitments may consist of payments or commitments made to governments or not-for-profit organizations for the costs of transportation infrastructure, other government services infrastructure (such as a police station), ongoing government services (such as an increased annual police budget), or other related costs. The payments or commitments may take the form of a cash payment, donations of land or other real property, or other forms.

² See footnote 1 for examples of the types of costs incurred. Only one-time costs incurred in connection with and contractually related to obtaining the license is capitalized. Ongoing future costs, such as annual police department funding, are not capitalized because they are generally conditional on continuing operations.

³ For additional guidance in determining the useful life of an intangible asset, refer to FASB ASC 350-30-35.

For example, certain jurisdictions restrict the number of gaming licenses and allow for these licenses to be renewed on a periodic basis only after a review by the gaming regulator. Generally, if the regulatory review focuses primarily on objective criteria, such as financial viability and the gaming entity's long-term business plans and ethics, and the regulator does not have a history of revoking gaming licenses, the gaming entity may be able to conclude the gaming license has an indefinite life because renewal is insignificant. If, on the other hand, such renewal is not perfunctory, the cost of renewal is material, or the regulator has a history of revoking licenses, then a gaming entity would generally conclude there is a finite life to the license and would amortize the asset over its expected life (typically, the initial period for which the gaming license is granted).

7.09 Intangible assets, such as a gaming license, that have an indefinite life are assessed for impairment in accordance with the provisions of FASB ASC 350. Intangible assets, such as a gaming license, that have a finite life are assessed for impairment in accordance with the provisions of FASB ASC 360, *Property, Plant, and Equipment*.

Project Development Costs

7.10 A gaming entity may incur costs in advance of construction of a new gaming facility, but after obtaining the gaming license, and the incurrence of such costs may be a condition of obtaining the right to construct the gaming facility (such as a condition of permitting).⁴ Such costs might also be similar to those described in FASB ASC 970-360-35-1. Although FASB ASC 970 does not apply to real estate projects developed for an entity's own use, gaming entities often apply the guidance in FASB ASC 970-360-35-1 by analogy.

7.11 For example, project costs for a gaming facility may include the cost of an asset constructed on behalf of a municipality and donated to the municipality, such as a pedestrian bridge to facilitate better traffic flow around the new gaming facility. Costs incurred that benefit the gaming facility to be constructed, and are a condition to the construction, are generally capitalized as part of the cost of the gaming facility, regardless of whether the gaming entity retains title to the asset. Such costs are then amortized over the life of the related asset(s).

Preopening and Start-Up Costs

7.12 Certain costs that may be incurred in connection with the opening of a gaming facility may be subject to the provisions of FASB ASC 720-15, whereas other costs are accounted for in accordance with other existing authoritative accounting literature. Examples of costs associated with the opening of a gaming facility include the following:

- Recruiting new employees
- Relocation costs
- Training of new employees

⁴ Such costs may also be incurred in connection with a significant expansion of an existing facility, in which case the guidance in paragraphs 7.10–11 would also apply.

- Payroll for employees directly associated with the opening of the gaming facility
- Consultants hired to assist the gaming entity in opening the gaming facility
- Operating costs of the gaming facility prior to opening but after construction is complete, such as real estate taxes
- Direct advertising and marketing costs incurred in connection with the opening of the gaming facility
- Incremental office lease space used by the gaming entity prior to the opening of the gaming facility

7.13 Costs within the scope of FASB ASC 720-15 are to be expensed as incurred. Although FASB ASC 720-15 does not have any explicit classification or disclosure requirements, practice in the gaming industry has evolved to separately report costs of start-up activities on a line item in the income statement titled, "Preopening expenses" (or similar title) and to include, in addition to items under the scope of FASB ASC 720-15, other items related to the opening or expansion of gaming facilities, such as advertising costs. If material, gaming entities generally also include in the footnotes to the financial statements the nature of the items included in the "Preopening expenses" line item and the amount of each component of those costs. Gaming entities that include such costs within another income statement line item (that is, do not separately present preopening and start-up expenses on the statement of operations) generally disclose the amount of such costs included in the relevant income statement line item, if material.

Chapter 8

Managing Properties for Third Parties

Applicability: *This chapter provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.*

Background

8.01 A gaming entity may incur,¹ or commit to incur, amounts in efforts to obtain the right to manage a gaming property owned by a third party (the Managed Property). Amounts may also be incurred or committed in connection with an existing management agreement. Frequently, the Managed Property is owned by a state, local, or tribal government.

8.02 The gaming entity, in some circumstances, pays or commits to pay amounts to organizations designated by the owner of the Managed Property. Typically, the mission of the organization designated to receive the remittance, such as an educational foundation, is to serve the Managed Property's owner or, if the owner is a government, its population. The Managed Property's owner, therefore, typically has a beneficial interest in the organization designated to receive those remittances.

8.03 In some circumstances, remittances made by the gaming entity pursuant to management agreements are for expenses that would otherwise be incurred by the Managed Property. For example, the gaming entity may agree to employ employees for the benefit of the Managed Property, or pay certain expenses for the benefit of the Managed Property, such as rent, utilities, or information technology functions.

8.04 In some circumstances, amounts remitted by the gaming entity to the Managed Property are structured as loans. Repayment of such amounts, however, may be contingent upon the Managed Property realizing a contractually defined level of revenues, net income, or other defined financial measure.

Summary of Selected Accounting Literature

8.05 The primary accounting literature relating to amounts incurred related to management contracts is Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450 *Contingencies*; FASB ASC 350, *Intangibles—Goodwill and Other*; FASB ASC 360, *Property, Plant, and Equipment*, for discussion regarding impairment; FASB ASC 470-10-25

¹ Amounts to be remitted may include capital assets and other assets, as well as cash and cash equivalents.

explains the guidance in FASB ASC 470, *Debt*, as it relates to amounts contingent on future earnings, and FASB ASC 605-45 explains the guidance in FASB ASC 605, *Revenue Recognition*.

8.06 The Financial Reporting Executive Committee (FinREC, formerly the Accounting Standards Executive Committee) believes that the transactions contemplated in this chapter are exchange transactions, rather than charitable contributions; thus, the guidance in FASB ASC 958, *Not-for-Profit Entities* is not applicable.

Accounting by the Gaming Entity Managing the Third Party Owned Property

Gaming Entity's Costs Prior to Obtaining the Management Agreement

8.07 The gaming entity may incur costs as part of its efforts to obtain a management agreement. For example, the gaming entity may fund the cost of a feasibility study or the design of a proposed casino to be built by the Managed Property's owner.

8.08 Costs incurred prior to it being probable that the gaming entity will obtain the management agreement should be expensed as incurred, similar to the accounting treatment for the costs incurred in efforts to obtain gaming licenses.² Consistent with FASB ASC 450, the event is considered probable when it is determined to be likely that it will occur.

8.09 Once the gaming entity believes that the likelihood of obtaining a management agreement is probable, certain costs incurred by the gaming entity are capitalized.³ These costs are considered management contract acquisition costs, an intangible asset. Until the management agreement is awarded by the Managed Property's owner, the intangible asset should be tested for recoverability in accordance with the requirements contained in FASB ASC 360 whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. Examples of events or changes in circumstances that might prompt such a test are provided in FASB ASC 360.

8.10 Once the management contract is awarded to the gaming entity, the useful life of the intangible asset should be assessed in accordance with the provisions of FASB ASC 350. Given that these assets typically have a finite life, the assets are generally amortized over a life equal to the term of the management agreement using a straight line method, unless evidence exists to support a different amortization method. Capitalized amounts should be evaluated for impairment in accordance with the provisions of FASB ASC 360.

8.11 If it becomes probable that the management contract will not be awarded to the gaming entity, any capitalized costs should be charged to expense.

² See chapter 7, "Gaming License, Project Development, and Preopening and Start-up Costs."

³ See chapter 10, "Long-Lived Assets," for a discussion of industry specific events that may trigger the need for an impairment review.

Gaming Entity's Costs Related to an Existing Management Agreement

8.12 The gaming entity may incur costs during the term of the management agreement that are similar in character to the costs incurred in efforts to obtain the agreement. In accordance with the provisions of FASB ASC 350, the costs incurred by the gaming entity related to an existing agreement should be capitalized and amortized over a life, not to exceed the remaining term of the management agreement, and should be reflected in the income statement as a reduction of revenue. Such amortization should be determined using a straight line method, unless evidence exists to support a different amortization method. Given that these assets typically have a finite life, capitalized amounts should be evaluated for impairment in accordance with the provisions of FASB ASC 360 whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.⁴

8.13 A gaming entity should report as expenses remittances made, or amounts otherwise incurred, pursuant to management agreements for expenses that would otherwise be incurred by the Managed Property. Examples of such costs that may be incurred by the gaming entity include compensation paid to employees hired for the benefit of the Managed Property, or expenses paid by the gaming entity for the benefit of the Managed Property, such as rent or utilities. Pursuant to FASB ASC 605-45, a gaming entity should report as revenue all amounts received or due pursuant to management agreements for the reimbursement of expenses described in the previous sentence.

8.14 For example, assume a gaming entity pays employees hired for the benefit of the Managed Property \$50,000 in monthly payroll. The Managed Property reimburses the gaming entity for this \$50,000 each month, in addition to the management fee payable under the management agreement. In these circumstances, each month the gaming entity would record \$50,000 in compensation expense for the amount paid to the employees and \$50,000 of revenue for the amount received as reimbursement from the Managed Property each.

Financial Statement Classification of Amounts Paid on Behalf of the Managed Property

8.15 Amounts remitted from the gaming entity to the Managed Property, or paid by the gaming entity to third parties on behalf of the Managed Property, may be reported as either loans receivable by, or an expense of, the gaming entity. In determining whether such amounts are receivables or expenses, the gaming entity should consider all relevant facts and circumstances, including but not limited to, whether repayment of such amounts is contingent on future earnings.

Accounting by the Managed Property⁵

8.16 Amounts may be remitted by the gaming entity to (or commitments may be made by the gaming entity to make remittances to) designated organizations in connection with agreements to manage the Managed Property, or in

⁴ See footnote 3.

⁵ The accounting discussed in this section applies only to nongovernmental gaming entities.

efforts to obtain the right to manage the Managed Property. In circumstances in which the Managed Property is not the primary obligor of the amounts paid, such amounts should not be reported in the Managed Property's financial statements unless the designated organizations are consolidated into the financial statements of the Managed Property.

8.17 In circumstances in which the Managed Property reimburses the gaming entity for costs paid on the Managed Property's behalf, the expense should be reported in the financial statements by the Managed Property according to its functional classification, rather than being reported as additional management fee expense. For example, assume the Managed Property reimburses the gaming entity for payroll costs as described in paragraph 8.14. In this example, the Managed Property would record \$50,000 of operating expense in its financial statements.

8.18 In circumstances in which the gaming entity pays costs on behalf of the Managed Property, but does not receive reimbursement other than via a management fee, the Managed Property should report such costs in its financial statements according to their functional classification, rather than as management fee expense. For example, assume the gaming entity pays the utility bills for the Managed Property pursuant to the terms of the management agreement. If the gaming entity paid \$100 for the Managed Property's utilities during the reporting period, the Managed Property would reclassify \$100 of expense from management fee expense to utility expense.

8.19 Amounts remitted to the Managed Property by the gaming entity would be reported as either loans payable by or revenue of the Managed Property. In determining whether such amounts are payables or revenues, the Managed Property should consider all relevant facts and circumstances, looking to the economic substance and nature of the transaction, including but not limited to whether repayment of such amounts is contingent on future earnings. FinREC believes that the factors outlined in FASB ASC 470-10-25 are among the considerations to be evaluated when determining the appropriate classification of such balances.

Disclosures

8.20 Many gaming entities conclude the requirements of FASB ASC 850, *Related Party Disclosures*, apply because the gaming entity either controls or can significantly influence the management or operating policies of the Managed Property to an extent that one of the parties might be prevented from fully pursuing its own separate interests. If FASB ASC 850 applies, the following information about management agreements should be disclosed in their respective financial statements:

- The nature of the relationship(s) involved
- A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements
- The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any

change in the method of establishing the terms from that used in the preceding period

- Amounts due from or to parties to the contract as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement

The accounting treatment of the transactions should also be disclosed.

8.21 The following example illustrates a disclosure made by the gaming entity pursuant to the guidance in paragraph 8.20:

In September 2004, the gaming entity entered into a five-year management agreement with Managed Property. Gaming entity provides key executive management personnel, facilities (including gaming equipment), and utilities in exchange for 7 percent of Managed Property's revenues. In connection with negotiating the management agreement with Managed Property, gaming entity agreed to make certain payments, including \$1,000,000 to the XYZ Educational Foundation, a not-for-profit organization serving constituents of the owner of the Managed Property. Gaming entity recorded this payment as a management contract acquisition cost and is amortizing the payment to expense over the life of the management contract on a straight line basis. For the year ended December 31, 2006, gaming entity recognized \$1,500,000 of revenue and \$800,000 of expenses in connection with the agreement. At December 31, 2006, gaming entity had a \$250,000 receivable from Managed Property. Payment of this balance was received in January 2007.

Chapter 9

Guarantees

Applicability: This chapter provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.

Introduction

9.01 Gaming entities and entities engaged in gaming activities (sometimes referred to hereafter as the *manager*) may guarantee all or part of the debt of unaffiliated gaming entities that they manage. The guarantee typically enables the unaffiliated entity to obtain financing or more favorable financing terms, or both. Such guarantees may be part of a transaction with multiple elements in which the manager, for example, may help an unaffiliated casino (a) obtain financing, (b) develop, construct, and open the casino, and (c) manage the casino.

Summary of Selected Accounting Literature

9.02 Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 460, *Guarantees*, is the primary accounting guidance for guarantees. FASB ASC 460 requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FASB ASC 460 also defines the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees that it has issued.

9.03 In addition to the guidance provided in FASB ASC 460, consider the following guidance to assist in accounting for these activities: FASB ASC 450, *Contingencies*; FASB ASC 350 *Intangibles—Goodwill and Other*; FASB ASC 360, *Property, Plant, and Equipment*; FASB ASC 820, *Fair Value Measurements and Disclosures*; FASB ASC 825, *Financial Instruments*; FASB ASC 460-10-35 as explained in FASB ASC 460; FASB ASC 820-10-65 as explained in FASB ASC 820; FASB ASC 605-20 explaining the accounting of fee income received by the guarantor; FASB ASC 605-25* addressing multiple element

* In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*, to significantly improve the accounting and reporting of transactions involving multiple-deliverable arrangements to more closely reflect the underlying economics of transactions. ASU No. 2009-13 amends FASB *Accounting Standards Codification* (ASC) 605-25 to

1. require separating consideration in multiple-deliverable arrangements in more circumstances than under existing generally accepted accounting principles.
2. establish a selling-price hierarchy for determining the selling price of a deliverable.

(continued)

arrangements; and FASB ASC 605-50 regarding customer payments and incentives, all explained in FASB ASC 605, *Revenue*. Readers may also refer to the illustrative guidance presented in appendix B, "Illustrative Guidance When Accounting for Guarantees," of this guide when accounting for guarantees.

Initial Recognition and Measurement of the Guarantee

9.04 FASB ASC 460-10-30-3 provides that the measurement basis for the liability reported by the guarantor is the greater of (a) the amount that satisfies the fair value objective or (b) the contingent liability amount required to be recognized at inception of the guarantee provided by FASB ASC 450-20-30.

9.05 FASB ASC 460-10-30-2 discusses certain circumstances in which guarantees are issued and methodologies for determining fair value in those circumstances. Those circumstances and that discussion include, in part, the following:

- When a guarantee is issued in a standalone arm's length transaction with an unrelated party, the liability recognized at the inception of the guarantee should, as a practical expedient, be the premium received or receivable by the guarantor.
- When a guarantee is issued as part of a transaction with multiple elements with an unrelated party, the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. This estimate should, as a practical expedient, consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's length transaction with an unrelated party.

9.06 Under the guidance of FASB ASC 820,¹ the fair value measure of a liability is the price that would be paid to transfer that liability to a market participant at the measurement date, with no change in the obligor credit rating. FASB ASC 820 also establishes a hierarchy that prioritizes the inputs to valuation techniques into three broad levels. The facts and circumstances under which the guarantee was issued should be considered in determining the inputs to valuation techniques when calculating the fair value of the guarantee.

(footnote continued)

3. replace the term *fair value* in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant.
4. eliminate the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method.
5. require that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis.
6. significantly expand the disclosures related to a vendor's multiple-deliverable revenue arrangements.

ASU No. 2009-13 should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless the vendor elects to adopt the pending content in this ASU on a retroactive basis in accordance with FASB ASC 605-25-65-1(e). Early application is permitted. See FASB ASC 605-25-65-1 for specific disclosure requirements related to early application and adoption year disclosure requirements.

¹ For additional guidance, refer to FASB ASC 820-10-65-4 for assistance in determining fair value when the volume and level of activity for the asset or liability have significantly decreased and for identifying transactions that are not orderly.

For example, the contract may define a specific fee to be paid to the manager in exchange for providing a guarantee, or the contract fee structure may provide for a change in the fee if the guarantee is no longer required. Although the contract may stipulate a fee to be paid in exchange for providing the guarantee, it should not be assumed that the stipulated fee reflects the fair value of the guarantee. The gaming entity should assess whether or not the contract terms represent the true economics of providing the guarantee.

9.07 In some circumstances, the probability of making payments under the guarantee may be small. Regardless of the likelihood of making payments under the guarantee, the guarantee's fair value should be determined.

9.08 The manager should record the estimated fair value of the guarantee as a liability in its statement of financial position.

9.09 FASB ASC 460-10-25-4 and FASB ASC 460-10-55-23 discuss, but do not prescribe, the accounting for the offsetting entry, a debit, arising from the recognition of the liability at inception of a guarantee. FASB ASC 460 45 provides that the offsetting entry, a debit, depends on the circumstances in which a guarantee was issued. Some examples cited in FASB ASC 460 include the recognition of cash or a receivable in a standalone transaction; an adjustment of the calculation of the gain or loss in a sale transaction; an increase in an investment in the formation of a venture, as prepaid rent in a leasing transaction accounted for under FASB ASC 840-20-25-1 as explained in FASB ASC 840, *Leases*; or as an expense.

9.10 The Financial Reporting Executive Committee (FinREC, formerly the Accounting Standards Executive Committee) discussed the following possibilities for the classification of the offsetting debit to be recorded when a liability for fair value of the guarantee is recorded (as either a receivable or a contract acquisition cost, depending on the facts and circumstances):

- As a receivable, representing the portion of the management fee that should be recognized as a separate accounting unit pursuant to FASB ASC 605-25
- As a contract acquisition cost asset, representing an economic sacrifice that the guarantor made with an aim toward acquiring the contract and the ability to earn management fee revenue

9.11 Classification of the offsetting debit as a receivable reflects a view that the existence of the guarantee creates an obligation for which the guarantor is to be compensated, and the offsetting debit to that liability is a receivable from the borrower. FinREC observes that the gaming entity owes the manager no money at the inception of the contract and, therefore, reporting the offsetting debit as a receivable would not be preferable because receiving fees for any element of the management agreement is contingent on the occurrence of future events. FinREC also believes it is inconsistent to report a receivable for the portion of the overall management fee that would be allocated to the guarantee pursuant to a FASB ASC 605-25 model, while reporting no receivable for the portion of the overall management fee that would be allocated to the elements of the contract other than the guarantee.

9.12 When issued in connection with a management agreement, the offsetting debit arising from the issuance of the guarantee satisfies the three essential characteristics of an asset as defined in paragraph 26 of FASB Concept Statement No. 6, *Elements of Financial Statements*. The offsetting debit

(a) embodies a probable future benefit that involves a capacity to contribute to future cash inflows, (b) the manager can obtain the benefit and control other's access to it, and (c) the transaction giving rise to the manager's right to control the benefit has already occurred.

9.13 FinREC's preference in circumstances in which the manager guarantees all or part of the debt of a gaming entity in conjunction with a management agreement is for the manager to record a contract acquisition cost asset as the offsetting debit when the manager recognizes the liability at the inception of the guarantee.

Income Statement Effect at Initial Recognition

9.14 FinREC considered whether the initial recognition of the guarantee should affect revenues or expenses. FinREC believes that providing the guarantee in connection with a management agreement, in and of itself, has no effect on net assets, and the earnings process has not been completed. That conclusion is reflected in the fact that liabilities and assets are recorded for equal amounts at initial recognition. Because an asset (the contract acquisition cost) and liability (guarantee) are recorded for the fair value of the guarantee at the initial recognition, and that agreeing to provide the guarantee is not the culmination of an earnings process, FinREC believes the initial recognition of the guarantee has no immediate income statement effect.

Classification of the Contract or Customer Acquisition Cost

9.15 Under FASB ASC 350-30-45-1, the contract acquisition cost asset shall be aggregated with other intangible assets in the statement of financial position or presented as a separate line item.

Subsequent Measurement of the Liability

9.16 FASB ASC 460-10-35-1 provides that the liability initially recognized by the manager would typically be reduced (by a credit to earnings) as it is released from risk under the guarantee. This guidance is consistent with the consensus reached in FASB ASC 605-20-25-9, which provides that fee income received by a guarantor should be recognized as income over the life of the guarantee. Depending on the nature of the guarantee, the manager's release from risk is typically recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes. The method described in (c) can only be used if, as discussed in FASB ASC 460-10-35-2, its use can be justified under generally accepted accounting principles. Examples of circumstances in which the method described in (c) would be appropriate include when the guarantee falls under the guidance of FASB ASC 815, *Derivatives and Hedging* and when the guarantor has elected to value the guarantee using the fair value option as provided by FASB ASC 825. FinREC believes that the method described in (b) is most commonly used in practice, and that the method described in (c) is rarely, if ever, used other than when the guarantee falls under the guidance of FASB ASC 815 or FASB ASC 825.

9.17 In circumstances in which the reduction of risk is recognized upon either expiration or release of the guarantee, the liability is typically measured at the greater of the liability amount as calculated under FASB ASC 450 or its initial amount under FASB ASC 460 until the guarantee either expires or is released.

9.18 In circumstances in which the reduction of risk is recognized by a systematic and rational amortization method, the liability is typically reduced with an offsetting credit to earnings. Some examples of systematic and rational amortization methods include the following:

- Straight line over the life of the guarantee
- Straight line over the life of the guarantee, with a proportionate reduction of the liability if a portion of the debt is prepaid or the manager is released from the guarantee obligation
- Proportionately as the debt is reduced, if the manager is released from a portion of the guarantee obligation

9.19 As described in paragraphs 9.17–18, if the manager is released from risk because of changes in the guarantee, such as upon retirement of the debt or if the guarantee is otherwise terminated, the liability should typically be reduced and a corresponding credit to other income or revenue recorded, consistent with the reporting of the amortization of the liability.

9.20 The method for reducing the liability is an accounting policy and should be applied consistently to different guarantees, given similar facts and circumstances. The policy should be disclosed.

9.21 The credit recorded as the liability is reduced may be reported as other income or revenue, as appropriate. The guarantor may either disaggregate the credit on the income statement or aggregate it with management fee revenue.

9.22 In circumstances in which it is probable that the manager has incurred a loss from the contingency, the amount of the loss can be reasonably estimated, and the estimated loss is greater than the remaining liability recorded under FASB ASC 460, the manager should recognize the incremental liability pursuant to FASB ASC 450-20-30 by a charge to expense.

Subsequent Measurement of the Asset

9.23 FinREC observes that FASB ASC 605-50-45-3 provides that

if the consideration consists of a free product or service (for example, a gift certificate from the vendor or a free airline ticket that will be honored by another, unrelated entity), or anything other than cash (including credits that the customer can apply against trade amounts owed to the vendor)...the cost of the consideration should be characterized as an expense (as opposed to a reduction of revenue) when recognized in the vendor's income statement.

FinREC considered whether the guidance in FASB ASC 605-50-45-3 requires amortization of the balance sheet debit as an expense, rather than as contra revenue. FinREC observed that amortizing the customer acquisition costs as an expense, rather than contra revenue, would result in reporting more revenue over the life of the contract than cash received. In addition, FinREC believes that although no receivable resulted from the agreement because payments are contingent, the agreement is, nevertheless, a multiple element arrangement pursuant to FASB ASC 605-25. Given the difficulty in categorizing the balance sheet debit, as well as the fact that FinREC believes it is undesirable to report more revenue over the life of the contract than cash received, FinREC believes the balance sheet debit should be amortized as a contra to revenue (or as a

reduction of other income, if the reduction of the guarantee liability is being recognized as other income).

9.24 The contract acquisition cost asset should be amortized over its estimated useful life. The estimated useful life of the asset to the manager should be based on an analysis of all pertinent factors, in particular the factors listed in FASB ASC 350-30-35-3.

9.25 FASB ASC 350-30-35-6 states, in part, that the method of amortization shall reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight line amortization method shall be used. FinREC believes most entities use the straight line amortization method because that pattern best reflects the economic benefits of the asset as it is used up. Although other amortization methods may be utilized, FinREC believes that the amortization expense should not be recorded more slowly than that amount, which would be recognized using the straight line method.

9.26 In conformity with FASB ASC 350-30-35-9, the manager should evaluate the remaining useful life of the contract acquisition cost asset that is being amortized each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. If the estimate of the asset's remaining useful life is changed, the remaining carrying amount of the asset should be amortized prospectively over that revised remaining useful life.

9.27 In conformity with FASB ASC 350-30-35-14, assets subject to amortization should be reviewed for impairment in conformity with FASB ASC 360-10-35-17 through 360-10-35-35.

Financial Statement Disclosures

9.28 The manager should provide disclosures required by FASB ASC 460-10-50-4 in addition to disclosing the nature of the offsetting entry arising from the recognition of the guarantee liability recorded on the balance sheet and its applicable accounting treatment.

Applicability of FASB ASC 810, *Consolidation*

9.29 FinREC observes that in practice, in most, if not all, transactions in which gaming entities manage and guarantee the debt of other entities undertaking gaming activities, the entity receiving management services is a governmental entity. FinREC considered whether to provide additional guidance on the application of FASB ASC 810 as it relates to gaming entities that manage and guarantee the debt of other entities undertaking gaming activities. The scope of FASB ASC 810 excludes the consolidation of governmental entities, as described in FASB ASC 810-10-15-12 as follows:

A reporting entity shall not consolidate a governmental organization and shall not consolidate a financing entity established by a governmental organization unless the financing entity meets both the following conditions:

- (1) is not a governmental organization
- (2) is used by the business entity in a manner similar to a variable interest entity (VIE) in an effort to circumvent the provisions of the Variable Interest Entities Subsections.

In circumstances in which gaming entities manage and guarantee the debt of other entities undertaking gaming activities included in the scope of FASB ASC 810, if any, gaming entities should consider the applicability of FASB ASC 810.

Chapter 10

Long-Lived Assets

Applicability: This chapter provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.

Introduction

10.01 Certain operating characteristics of gaming entities and other entities with gaming related activities, as well as the environment in which they operate, create considerations for industry specific financial reporting pertaining to those long-lived assets.

Summary of Selected Accounting Literature

10.02 The primary sources of accounting guidance for impairment of long-lived assets are Financial Accounting Standards Board (FASB) *Accounting Standards Codification (ASC) 360, Property, Plant, and Equipment*; FASB ASC 410, *Asset Retirement and Environmental Obligations*; and related guidance.

Long-Lived Assets to Be Held and Used

10.03 FASB ASC 360 addresses financial accounting and reporting for the impairment or disposal of long-lived assets, including intangible assets that are subject to amortization. The statement requires that a long-lived asset (asset group) to be held and used be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. Such events or changes in circumstances are commonly referred to as *triggering events*.

Triggering Events

10.04 FASB ASC 360-10-35-21 provides examples of events or changes in circumstances (triggering events) indicating that a long-lived asset (asset group) carrying amount may not be recoverable. For gaming entities and other entities with gaming related activities, the following are some industry specific examples of events or changes that may cause significant adverse changes in a long-lived asset (asset group) being used:

- Examples of events or changes in the extent or manner of use of a long-lived asset (asset group) include the following:
 - Converting a facility in which gaming operations are undertaken from a cruising riverboat to a stationary barge
 - Closing or abandoning an entertainment facility within a casino, hotel, and entertainment complex

- Examples of events or changes in legal factors that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator includes the following:
 - An increase in gaming tax rates
 - The legalization of gaming in a nearby location
 - A change in regulation significantly increasing the number of gaming licenses in the jurisdiction in which the entity operates
 - A change in legislation limiting or prohibiting the type or nature of games allowed
 - A change in legislation limiting the amount of time individual players may spend in the gaming operation
 - A change in legislation limiting the amount that an individual player may lose in a given time period
 - A change in legislation limiting or prohibiting the nature and extent of certain nongaming behavior and activities undertaken by players in the gaming operation, such as smoking cigarettes or drinking alcohol

- Examples of events or changes in circumstances that may significantly adversely change the business climate that could affect the value of a long-lived asset (asset group) include the following:
 - An increase in competition resulting from changes in legislation or regulations
 - An increase in competition from the introduction of competing alternative gaming venues
 - An observable decline in travel and tourism resulting from economic, political, social, or other reasons

10.05 The factors and events may also create gradual changes that may not necessarily be triggering events because each separate occurrence of such gradual changes may not indicate that the carrying amount of the asset (asset group) may not be recoverable. Over time, gradual changes may result in changes in circumstances indicating that the carrying amount of the asset (asset group) may not be recoverable. For example, such gradual changes may result in a deterioration of operating results.

10.06 Certain changes in circumstances or events or an aggregation of several factors may have a long-term effect, whereas others may be likely to be temporary. For example, legalization of gaming in a nearby location may have a long-term effect, whereas the effects of a power outage may be temporary. An entity should consider the extent to which a particular event or change in circumstances affects future periods in determining whether it is a triggering event. In addition, if a particular event or change in circumstances is considered a triggering event, the entity should consider the extent of the effect of such events or changes in circumstances on future periods in estimating future cash flows used to test the recoverability of a long-lived asset (asset group).

Grouping Long-Lived Assets to Be Held and Used and Related Issues

10.07 FASB ASC 360-10-35-23 through 360-10-35-24 discusses the grouping of long-lived assets. Determining the appropriate level of assets to group for gaming entities and other entities with gaming related activities presents unique issues in certain circumstances.

10.08 Gaming activities are conducted in buildings or facilities that also have hotels, restaurants, shops, spas, entertainment facilities, and other related activities. Those separate assets and activities typically are related to, and dependent on, each other. Although those separate assets and activities may generate positive identifiable cash flows, the primary focus of the overall building or complex is on attracting customers for the gaming activities, and the identifiable cash flows of those separate assets and activities, therefore, may not be largely independent of the cash flows of other assets and liabilities. Accordingly, the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities, for example, may be the combined casino, hotel, and entertainment complex, due to the interdependency of the operations. In such circumstances, such assets should be grouped together for purposes of considering the provisions of FASB ASC 360. However, in circumstances in which identifiable cash flows that are largely independent of the cash flows of other assets and liabilities can be identified, long-lived assets should be grouped accordingly.

10.09 In some circumstances, entities may own multiple facilities, such as multiple casino, hotel, and entertainment facilities. For example, an entity may own three casino and hotel facilities in a particular city. Although those three facilities may have certain shared costs, typically, those three facilities would have identifiable cash flows that are largely independent of the cash flows of assets and liabilities of the other two facilities in the same city.

10.10 FASB ASC 360-10-35-22 discusses the useful lives and depreciation of long-lived assets, and FASB ASC 360-10-35-47 through 360-10-35-48 discusses long-lived assets to be abandoned and depreciation estimates.

10.11 In some circumstances, events or changes in circumstances may affect a particular asset within an asset group without resulting in an impairment loss for the asset group. Although such events or changes in circumstances may not necessarily result in an impairment loss for the asset group, they may, nevertheless, require accounting recognition. In particular, as an example, in circumstances in which a casino commits to a plan to abandon a long-lived asset before the end of its previously estimated useful life, depreciation estimates should be revised in conformity with FASB ASC 250, *Accounting Changes and Error Corrections*, to reflect the use of the asset over its shortened useful life. A long-lived asset that has been temporarily idled should not be accounted for as if abandoned.

10.12 Other events and changes in circumstances may raise issues about the composition of asset groups and related measurement issues. For example, some entities operate a casino and hotel complex and conduct its gaming activities in a casino on a riverboat because legislation prohibits gaming activities on stationary barges. Identifiable cash flows pertaining to any particular asset within the complex are not largely independent of the cash flows of other assets and liabilities within the complex. Because of the interdependency of

the operations, the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities is the combined casino and hotel complex, with changes in legislation allowing the entity to operate its gaming activities in a casino on a stationary barge. If the entity moved all the gaming machines, tables, and casino equipment to the barge and kept and converted the riverboat at the dock into an entertainment facility, the entity should consider whether, as a result of converting the riverboat into an entertainment facility, cash flows for the entertainment facility are largely independent of the cash flows of other assets and liabilities in the combined casino and hotel complex. In circumstances in which the cash flows for the entertainment facility are largely independent of the cash flows of other assets and liabilities in the combined casino and hotel complex, the entity should consider whether an impairment loss pertaining to the entertainment facility has been incurred. In circumstances in which the cash flows for the entertainment facility are not largely independent of the cash flows of other assets and liabilities in the combined casino, hotel, and entertainment complex, the entity should consider whether an impairment loss pertaining to the casino, hotel, and entertainment complex as a whole has been incurred. Also, the entity should review depreciation estimates and methods pertaining to the entertainment facility, as required by FASB ASC 250.

Estimates of Future Cash Flows Used to Test a Long-Lived Asset for Recoverability

10.13 FASB ASC 360-10-35-29 and 360-10-35-31 discuss the estimates of future cash flows used to test the recoverability of a long-lived asset. Accordingly, estimates of future cash flows used to test the recoverability of a long-lived asset (asset group) should be made for the remaining useful life of the asset (asset group) to the entity. In addition, the remaining useful life of an asset group should be based on the remaining useful life of the primary asset of the group.

10.14 For gaming entities and other entities with gaming related activities, the primary asset typically may be the facility in which gaming activities are undertaken, if housed separately. If the facility in which gaming activities are conducted in the same physical facility as other activities, such as hotels, restaurants, shops, spas, entertainment facilities, and other related activities, the primary asset typically may be the overall building in which those activities are housed. At times, the gaming activities may be so integral to the purpose of the entity and its overall objectives that the other assets in the group typically would not have been acquired by the entity without the facility housing the gaming activities.¹ Accordingly, even in circumstances in which (a) the level of investment required to replace assets other than the facility housing the gaming activities or (b) the remaining useful life of assets other than the facility housing the gaming activities might otherwise point toward those other assets as being the primary asset, the facility housing the gaming activities typically may be the primary asset.

10.15 Circumstances may exist, however, in which the facility housing the gaming activities is not the primary asset. For example, a cruise ship

¹ Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 360-10-35-31 explains that the primary asset group cannot be land or an intangible asset not being amortized. Accordingly, nonamortizing licenses, goodwill, or other intangible assets, if any, as well as land, if any, on which the casino facility is built should not be considered the primary asset.

may include a relatively small casino area. In these circumstances, the entire cruise ship, rather than the casino area, typically would be the primary asset. As another example, a racetrack facility may include a separate facility that includes slot machines. In such circumstances, the entire race track facility may be the primary asset.

10.16 As noted in FASB ASC 360-10-35-31, the remaining useful life of an asset group should be based on the remaining useful life of the primary asset of the group. In circumstances in which any assets will be included within the asset group at the date at which the primary asset will be disposed of, including but not limited to circumstances in which the primary asset is not the asset of the group with the longest remaining useful life, estimates of future cash flows for the asset group should assume the sale of the balance of the group at the expected disposal date of the primary asset. For gaming entities and other entities with gaming related activities, the cash flow estimation period, therefore, may differ from the remaining depreciable life of the gaming facility for various reasons.² Also, it may be difficult to reliably estimate cash flows for the entire period of the facility's remaining useful life due to the difficulty in forecasting future revenue growth and capital expenditures over a prolonged period. In those circumstances, as suggested in FASB ASC 360-10-35-30, a probability-weighted approach may be useful in considering the likelihood of various possible outcomes. Also, pursuant to FASB ASC 360-10-35-30, to the extent that the potential sale of the long-lived asset (asset group) exists, then such a sale should be considered in determining the probability-weighted cash flows used to evaluate and measure for impairment.

10.17 FASB 360-10-35-33 and 360-10-35-35 discusses estimates of future cash flows and the existing service potential of the assets (assets group), including capital expenditures to maintain the service potential of the assets (assets group).

10.18 Some examples of a gaming entity's cash flows necessary to maintain the existing service potential of the asset (asset group) includes slot machine replacements, carpet replacement, general refurbishment of common areas, and information systems upgrades or replacements.

10.19 Examples of cash flows necessary to maintain the existing service potential of the group for gaming entities with hotel amenities include those incurred to improve the hotel and its rooms, including refurbishments and remodels to maintain the existing service potential of the asset group.

Asset Retirement Obligations³

10.20 Some gaming entities and other entities with gaming related activities incur legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, or development or the normal operation of the long-lived asset, or both. Such obligations should be reported in conformity with FASB ASC 410. Some examples of those obligations are as follows:

² As stated in FASB ASC 360-10-35-22, when a long-lived asset (asset group) is tested for recoverability, it also may be necessary to review depreciation estimates and methods as required by FASB ASC 250, *Accounting Changes and Error Corrections*, or the amortization period as required by FASB ASC 350, *Intangibles—Goodwill and Others*.

³ Not all obligations are considered asset retirement obligations, and readers should refer to the guidance found in FASB ASC 410-20-15-3.

Gaming

- A casino builds a moat for purposes of holding a barge functioning as a gaming facility, with the legal obligation to refill the moat with land if the facility ceases to be used for gaming activities.
 - A casino enters into a land lease and builds a facility on that land, with the legal obligation to remove the building at the end of the lease term.
-

Chapter 11

Other Accounting Topics

Applicability: This chapter provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.

Intangible Assets Acquired in a Business Combination

11.01 Some gaming entities operate in limited license jurisdictions, and the license itself may, therefore, have value. Even though licenses are typically not legally separable, they can meet the contractual or legal rights requirements of Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 350, *Intangibles—Goodwill and Other*, for recognition as an asset apart from goodwill. The fair value of a license is often determined based on an "excess earnings" approach. The other important issue is the determination of whether the license has finite lives or is indefinite lived. A detailed review of the criteria in FASB ASC 350¹ is required; however, gaming entities have historically determined that such licenses are indefinite lived primarily because renewal is expected to occur without a substantial cost and without material modification to the terms and conditions of the license. Also see chapter 7, "Gaming License, Project Development, and Preopening and Start-Up Costs," of this guide.

11.02 Trademarks can be a significant intangible asset in an acquisition of a gaming entity. Such assets are generally valued using a methodology that computes the hypothetical charge under a license arrangement if the gaming entity did not have rights to the trademark, but had to rent, or license, those identical rights.

11.03 The valuation of customer relationship intangible assets will generally be determined using a discounted cash flow method based on the cash flows specifically related to the subject customers. One key assumption is the attrition rate because customer relationship intangible assets are only recognized for current customers; it can be assumed that they will not be customers forever. Additional assumptions that are important include the relevant costs/profit margins assigned to these customers, which is potentially different from the costs/profit margins of the gaming entity as a whole. Similarly, a relevant discount rate must be selected.

11.04 Evidence of continuing involvement with established customer relationships, which could potentially be recognizable in an acquisition of a gaming entity, include the following:

¹ For additional guidance, refer to Financial Accounting Standards Board *Accounting Standards Codification* 350-30 to assist in determining the useful life of intangible assets.

- An existing point-loyalty program with a database of known customers
- Situations in which the gaming entity has regular contact with the customer, such as the case with premium gaming customers
- The existence of advance hotel reservations

Jackpot Insurance

Background

11.05 Some gaming entities insure against risks of gaming losses that they will be required to pay out on certain jackpots (referred to hereafter as jackpot insurance). In a typical jackpot insurance arrangement, the gaming entity pays a premium to a bona fide insurance company in exchange for the insurer reimbursing the gaming entity if a patron wins a specified jackpot. Although jackpot insurance may be purchased for any game with a large payout, such insurance is most commonly purchased for games such as keno, bingo, and some slot machines jackpots.²

11.06 Jackpot insurance typically is priced based on the payout percentage for the game, as set by the gaming entity, with a profit built in for the insurer. Jackpot insurance, therefore, effectively transfers the gaming risk for the insured jackpot from the gaming entity to the insurer. Jackpot insurance does not, however, legally replace the gaming entity with the insurer as the obligated party in circumstances in which a patron wins a jackpot. Over periods of extended play, having jackpot insurance results in the gaming entity earning slightly less with respect to the insured game than the gaming entity would earn without the insurance, but jackpot insurance significantly reduces the gaming entity's risk that it will incur a relatively large cash outflow in any particular time period. Jackpot insurance, therefore, is a means for the gaming entity to manage the cash flows of the insured activities. The excess of insurance premiums over the probable *jackpot payout* represents the cost of managing those cash flows.

11.07 Premiums for jackpot insurance and proceeds paid by insurers are typically not included in the computation of taxable gaming revenue in most, if not all, jurisdictions.

Characteristics of Jackpot Insurance Policies

11.08 The products offered are short duration insurance contracts, and the gaming entity is compensated only if an identifiable insurable event occurs (that is, a jackpot is won by a patron), and the gaming entity incurs a liability. Payments are not made by the insurance company based on changes in a variable. Jackpot insurance may be considered analogous to payment of death benefits on a term life insurance contract or payment of benefits on an annually renewable property and casualty contract after a theft or fire. It must be emphasized that in order to be considered insurance for accounting purposes, significant gaming risk is transferred from the gaming entity to the insurer under jackpot insurance contracts.

² Promotional payouts not associated with gaming activities are not included in the discussion in this chapter.

11.09 Jackpot insurance is not typically offered with other insurance or combined with embedded derivative instruments.

11.10 Typically, jackpot insurance contains no financing or loan arrangements. There is no guarantee that a jackpot will be paid during the limited term of the insurance contract, so the insurer is not financing the payment of the jackpot for the gaming entity. Just the opposite—the insurer has computed the odds of a large jackpot being won and would prefer that the large payout *not* be paid during the term of the contract.

Accounting for Jackpot Insurance

11.11 Games covered by jackpot insurance are to be accounted for in the same manner as games not covered by insurance. Wins are computed in the same manner, with payouts made on winning wagers that are insured being accounted for as a reduction of gaming win, and will be reflected as a component of gross gaming revenue.

11.12 Gaming entities report the jackpot insurance premiums as a component of net gaming revenue. To the extent that jackpot insurance premiums are prepaid, they are deferred and amortized over the remaining contract period in proportion to the amount of insurance protection provided. Recoveries under jackpot insurance policies are also reported as a component of net gaming revenue.

11.13 Receivables arising from jackpot insurance are reported separately as assets and are not offset against related jackpot liabilities.

Gaming Chips and Tokens Liabilities

11.14 The purchase cost of chips and tokens are either recorded as an asset and depreciated over their useful lives or, if not material, expensed immediately.

11.15 When accounting for gaming chips, FASB ASC 924-405-25-1 states that 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. Furthermore, FASB ASC 924-405-35-1 requires that the chip liability shall be 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).

11.16 The face value of chips and tokens that have been placed into service is part of the cash on hand balance, with a contra account recorded within the gaming entity's cash balance.

11.17 The liability for chips and tokens that are not under the control of the gaming entity (also known as the *chip / token float*³), is periodically reviewed and adjusted for chips and tokens when redemption by the customer has been deemed remote. This concept is commonly referred to as *breakage*, as described

³ Terms that appear in the glossary are shown in *italics* the first time they appear.

in FASB ASC glossary. The offsetting entry for the reduction in the chips and tokens liability is recorded as a component of net gaming revenue.⁴

11.18 Gaming entities may also periodically determine that certain denominations or themes of gaming chips or tokens will be permanently discontinued. Gaming regulations typically require that public notice (for example, legal notice in newspapers) be given for an extended period of time subsequent to the decision to discontinue the use of specific chips or tokens. Once the mandated notice period expires, the gaming entity is legally released from the redemption requirement, a liability no longer exists, and net gaming revenue is recognized for the dollar amount of chips and tokens that were not redeemed.

Racetrack Fees

Background

11.19 Some gaming entities, as a component of their operations, typically called the *race book*, receive simulcasts of horse and other races from various racing tracks (referred to hereafter as the *track entity*) and accept betting on the simulcast races. The gaming entity typically forwards the bets accepted on the simulcasts to the track entity, and the bets are commingled with the bets taken at the track (and at other gaming entities) as part of the pari-mutuel activity. Although rare, some gaming entities handle the bets themselves and form pari-mutuel pools from among the bets placed.

11.20 Gaming entities that take pari-mutuel bets on simulcast races typically receive a commission from the track entity in exchange for bringing wagers into the track entity's pari-mutuel pool. The commission percentage range depends on the racetrack and type of wager accepted.

11.21 Gaming entities that take pari-mutuel bets on races typically pay a fee to the track entity through a third party intermediary (such fees are commonly referred to hereafter as *track fees*). The track fees paid by the gaming entity typically are a fixed dollar fee per day, but can also be a percentage of wagers (if the state gaming commission has given its approval for the track entity to share in casino revenues). For gaming entities paying track fees as a percentage of wagers, the fee range is dependent upon the racetrack and type of wager. In substance, the track fee paid by the gaming entity is effectively a reduction, or discount, of the commission it receives. The transaction typically is structured in this manner in circumstances in which the track entity is required by regulation to remit to the gaming entity a specific amount, typically expressed as a percentage of wagers brought into the track entity's pari-mutuel pool. The gaming entity then pays an amount to the track entity to adjust the net payment to a market driven amount.

⁴ Escheat laws need to be considered when determining the appropriate accounting for breakage. The guidance in this paragraph assumes that breakage resulting from unredeemed chips and tokens is not considered abandoned property in the gaming entity's legal jurisdiction. In addition, registrants should consider the guidance discussed in a December 2005 speech made by the staff of the Securities and Exchange Commission (SEC) discussing the staff's view on the acceptable approaches to recognizing breakage. Refer to the following link to access this speech from the SEC's website, www.sec.gov.

Accounting for Racetrack Fees

11.22 Track fees incurred by the gaming entity are generally netted against commissions received from the track entity, regardless of whether such fees are calculated as a flat fee, a percentage of wagers, or a percentage of wagers with a maximum amount, and regardless of whether the track fees are paid through a third party intermediary. This treatment is consistent with the guidance for similar activities prescribed in FASB ASC 605-50 as explained in FASB ASC 605, *Revenue Recognition*.

11.23 The treatment of racetrack fees, as described in this chapter, is consistent with the guidance in this guide pertaining to third party management agreements in circumstances in which the gaming entity makes upfront payments to the managed entity and then amortizes those upfront payments against management fee revenue over the life of the agreement.

Segment Reporting

11.24 FASB ASC 280, *Segment Reporting*, 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.

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

11.26 When accounting for geographic segments, FASB ASC 924-280-50-1 states that the operations of a nonpublic business entity 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, nonpublic casino business entities operating in various legal jurisdictions may have geographic segments and, therefore, shall report such information.

Uniforms and Other Long-Lived Assets

11.27 A gaming entity's assets include their stock of uniforms, linens, china, glassware, and silver. A variety of methods are used to account for these assets and their consumption. Some gaming entities aggregate the cost of these items and depreciate the items over their estimated useful lives. Other gaming entities capitalize the base stock of these items and then expense the costs of items subsequently bought and placed in service. Under this method, the initial cost may be amortized to a preestablished net value or remain at full cost. Other gaming entities capitalize the cost of these items and expense the items when they are lost or damaged. However, if not material, some entities might expense these costs immediately. Generally, policies pertaining to the accounting method used are disclosed in accordance with FASB ASC 235, *Notes to Financial Statements*.

Deferred Income Taxes for Casinos

11.28 When accounting for the deferred income taxes of a casino, FASB ASC 924-740-25-1 states that the financial statement reporting for casinos differs from income tax reporting, resulting in deferred income taxes when any of the following conditions are met:

- 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.
 - c.* Progressive slot jackpots are accrued based on meter readings for financial statements and are charged against revenue when paid for income tax reporting.
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Chapter 12

Governmental Gaming Entities

Applicability: Tribal gaming, state lotteries, and other governmental gaming entities apply governmental accounting and financial reporting practices and should follow the guidance in this chapter. The guidance in this chapter does not apply to nongovernmental gaming entities.

Unless it conflicts with or contradicts Governmental Accounting Standards Board (GASB) pronouncements, governmental gaming entities should also consider the guidance in chapters 4–11, appendixes A–D, and the glossary of this guide as other accounting literature set forth in paragraph 6 of GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

Background

12.01 This chapter summarizes some areas of generally accepted accounting principles (GAAP) significant to governmental gaming entities. The AICPA Audit and Accounting Guide *State and Local Governments* includes governmental gaming entities in its scope and contains accounting and financial reporting guidance and other matters unique to governmental entities that should also be considered by governmental gaming entities.

Summary of Selected Accounting Literature

12.02 The primary sources of guidance in this chapter applicable to governmental entities are Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*; GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—State and Local Governments*; GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—State and Local Governments: Omnibus*; GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*; GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*; GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*; GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*,* and GASB Statement No. 62, *Codification of Accounting*

* On December 17, 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*, which amends GASB Statement No. 14, *The Financial Reporting Entity* and GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. GASB Statement No. 61 modifies the criteria for including component units and amends the criteria for blending component units in the financial statements of the primary government. In addition, when the presentation option of consolidating financial statement data is applied, GASB Statement No. 61 requires reporting condensed combining information in the notes to

(continued)

and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.[†]

GASB Statement No. 20 Election

12.03 Paragraph 6 of GASB Statement No. 20, as amended, requires that proprietary funds¹ apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins issued on or before November 30, 1989, that do not conflict with or contradict the GASB pronouncements. Furthermore, paragraph 7, as amended, of GASB Statement No. 20 provides that governmental enterprise funds and activities reported using enterprise fund accounting and financial reporting *may* apply all FASB statements and interpretations issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements (collectively, *post-1989 FASB pronouncements*). Governmental gaming entities that choose to apply post-1989 FASB pronouncements must apply them on an "all or none" basis and may not select which pronouncements to apply. GASB Statement No. 34, paragraphs 93–95, indefinitely extends the provisions of GASB Statement No. 20.

12.04 The election under GASB Statement No. 20 regarding whether or not to apply post-1989 FASB pronouncements may affect accounting and financial reporting by governmental gaming entities. Those electing not to implement post-1989 FASB pronouncements also do not implement revisions to pre-1989 FASB pronouncements made by post-1989 FASB pronouncements. As a result, GAAP applicable to such entities may include pronouncements that have been superseded for entities that follow the FASB model and

(footnote continued)

the financial statements for blended component units of primary governments that are business-type activities reported in a single column (that is, a state university). GASB Statement No. 61 also clarifies the requirements for reporting equity interests in component units. The requirements of the statement are effective for financial statements for periods beginning after June 15, 2012, and earlier application is encouraged.

[†] GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, is effective for periods beginning after December 15, 2011. Earlier application is encouraged. GASB Statement No. 62 incorporates into GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) statements and interpretations
2. Accounting Principles Board opinions
3. Accounting Research Bulletins of the AICPA Committee on Accounting Procedure.

GASB Statement No. 62 supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB statements and interpretations that do not conflict with or contradict GASB pronouncements. However, entities can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements.

¹ Proprietary funds are a "fund type" in the governmental accounting model, which includes enterprise funds and internal service funds. Proprietary funds are addressed in chapter 2, "Financial Reporting," of the AICPA Audit and Accounting Guide *State and Local Governments* and in section 1300 of the GASB codification.

governmental gaming entities that have elected to implement post-1989 FASB pronouncements.²

Basic Financial Statements and Required Supplementary Information[‡]

12.05 Governmental gaming entities are included in the financial statements of the sponsoring government, typically as business-type activities. Stand-alone financial statements of a governmental gaming entity may be important to management and the sponsoring government and its citizens. Stand-alone financial statements are typically required by gaming regulators and may be required by creditors when proceeds of debt are secured by the revenues or resources of the governmental gaming entity.

12.06 Accounting and financial reporting for separately issued GAAP-based financial statements for one or more individual funds are not currently addressed by GASB standards.³ However, for governmental gaming entities that are individual funds or groups of funds, auditors and preparers of financial statements should consider long-established practice dictating that those presentations should apply all relevant GAAP accounting standards and present all relevant financial statements, note disclosures, management discussion and analysis topics, and other required supplementary information.

12.07 All changes in net assets/equity of governmental gaming entities, including distributions to and contributions from the sponsoring government, are reported in the statement of revenues, expenses, and changes in net assets/equity. Because the statement of revenues, expenses, and changes in net assets/equity is all inclusive, the governmental financial reporting model does not include a separate statement of changes in stockholders equity as a basic financial statement.

Resource Flows Between Governmental Gaming Entities and Sponsoring Governments

12.08 Some examples of resource flows that commonly occur between governmental gaming entities and their sponsoring governments are as follows:

- Infusion of financial resources to the governmental gaming entity to begin or expand operations
- Contribution of capital assets to or from the primary government (capital contributions)

² Readers should refer directly to the applicable authoritative pronouncements and may consider referring to a nonauthoritative listing on GASB's website (www.gasb.org) providing guidance on whether post-1989 FASB pronouncements conflict with or contradict GASB pronouncements.

[‡] In November 2010, GASB approved an exposure draft of proposed statement, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. If adopted, the proposed statement would provide guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. Additionally, the proposed statement includes related amendments to the requirements of GASB Statement No. 34 and other pronouncements. The proposed effective date is for financial statements for periods beginning after June 15, 2011. Readers should be alert for the issuance of the final standard. The exposure draft may be found at www.gasb.org.

³ Accordingly, GASB did not clear provisions set forth in this paragraph.

- Return of financial resources (gaming profits) to the sponsoring government
- Taxes assessed on the governmental gaming entity by the sponsoring government
- Fees assessed by the sponsoring government on the governmental gaming entity
- Reimbursement of amounts paid for goods or services, or both, provided by or to the governmental gaming entity to or from the sponsoring government

12.09 Resource flows, other than capital contributions and reimbursements, are treated differently on the statement of revenues, expenses, and changes in equity, depending on whether the gaming entity is a part of the primary government (enterprise fund or blended component unit) or whether it is a discretely presented component unit. Gaming entities that are part of the primary government report such resource flows as transfers,⁴ whereas gaming entities that are discretely presented component units report such resource flows as nonoperating revenues and expenses.

12.10 Capital contributions (capital assets contributed to or from the sponsoring government) are reported, at the book value of the assets contributed, below nonoperating revenues and expenses on the statement of revenues, expenses, and changes in equity as "capital contributions." Reimbursement transactions settle assets and liabilities that were created when the original transaction occurred and have no further financial statement impact.

Allocation of Assets and Liabilities Within the Financial Reporting Entity

12.11 Long-term liabilities directly related to, and expected to be paid from, governmental gaming entities that are proprietary funds of the sponsoring government are reported as specific fund liabilities, even though the full faith and credit of the governmental unit may be pledged as further assurance that the liabilities will be paid.⁵ Except for such fund liabilities, governments generally determine how assets and liabilities are allocated within the financial reporting entity. To enhance the understandability of financial statements, the notes to the financial statements may disclose relationships affecting the operations of the governmental gaming entity that are not otherwise apparent. For example, a tribal casino may have the beneficial use of land, equipment, and facilities that are reported in a different fund or activity without charge. Similarly, a gaming entity may benefit from centralized administrative activities (for example, finance, accounting, human resources) of the government at no cost or at a reduced rate.

⁴ See paragraph 112 of GASB Statement No. 34 for additional information. The nature of such transfers may be provided on the face of the statement or in the notes to the financial statements.

⁵ See paragraph 42 of the National Council on Governmental Accounting Statement No. 1, *Governmental Accounting and Financial Reporting Principles*.

Impairment of Capital Assets

12.12 GASB Statement No. 42 specifies accounting for capital asset impairments and insurance recoveries by governmental gaming entities. *Impairment* is defined by GASB Statement No. 42 as "a significant, unexpected decline in the service utility of a capital asset." GASB Statement No. 42 provides that "the service utility of a capital asset is the usable capacity that at acquisition was expected to be used to provide service, as distinguished from the level of utilization, which is the portion of the usable capacity currently being used." GASB's service utility approach differs significantly from the cash flow based methodology for determining impairment under FASB standards.

12.13 GASB Statement No. 42 requires that an impairment test be performed if events or changes in circumstances that are prominent and that denote the presence of indicators of impairment exist. GASB Statement No. 42, paragraph 9 lists the following as common indicators of impairment:

- Physical damage
- Enactment or approval of laws or regulations or other changes in environmental factors
- Technological development or evidence of obsolescence
- Changes in the manner or expected duration of use of a capital asset
- Construction stoppage, such as a stoppage due to lack of funding

12.14 For governmental gaming entities, the following are factors that may be indicators of impairment (assuming such events differ from the gaming entity's expectations at the time the asset was acquired or built):

- Change in legislation limiting or prohibiting the type or nature of games allowed, such as prohibiting a certain type of game (this may be an indicator of impairment of specific games or machines rather than the gaming entity as a whole)
- Change in legislation limiting the amount of time the gaming entity is allowed to be open

12.15 Examples of changes in the manner or expected duration of use of a capital asset that may be indicators of impairment for governmental gaming entities include the following:

- Relocation of gaming operations from a cruising riverboat to a land-based casino
- Abandonment of an entertainment facility within a casino

12.16 The following circumstances are not indicators of impairment because although they may result in reduced profits or cash flows, they do not suggest that the service utility of the capital asset has significantly declined:

- Increase in gaming tax rates or revenue sharing obligations to states
- Legalization of gaming in a nearby location
- Change in regulation significantly increasing the number of gaming licenses in the entity's market

- Increased competition resulting from changes in legislation or regulations, for example, permitting other entities to conduct a certain type of game that would result in other entities having competitive advantages
- Increased competition from the introduction of competing alternative gaming venues, such as racinos or other casinos, in a nearby location
- Change in legislation (a) limiting the amount of time individual players may spend in the gaming entity, (b) limiting the amount that an individual player may lose in a given time period, or (c) limiting or prohibiting the nature and extent of certain nongaming behavior and activities undertaken by players in the gaming entity, such as smoking cigarettes or drinking alcohol
- An observable decline in travel and tourism resulting from economic, political, social, or other reasons

Segment Reporting

12.17 Segment reporting applicable to governmental entities specified by GASB Statement No. 34, paragraphs 122–123, is designed to facilitate reporting compliance with covenants related to debt backed by pledged revenue streams of enterprise funds. Governmental gaming entities frequently have pledged such revenue streams. Segment reporting is required when the pledged revenue stream is narrower than the activity of the fund. For example, segment reporting would be required in the stand-alone financial statements of governmental gaming entities and the basic financial statements of the sponsoring governmental entity when the gaming revenues are pledged, but the fund also includes other revenues that are not pledged.

Chapter 13

General Auditing Considerations¹

Introduction

13.01 In accordance with AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*), an auditor plans, conducts, and reports the results of an audit in accordance with generally accepted auditing standards (GAAS). Auditing standards provide a measure of audit quality and the objectives to be achieved in an audit. This section of the guide provides guidance, primarily on the application of the standards of fieldwork.

13.02 This section provides guidance for performing audits of entities that undertake gaming and gaming related activities that often involve unique and complex matters, providing guidance on the risk assessment process and general auditing considerations.

13.03 As is the case in all audits, the auditor exercises significant judgment in designing the audit plan and determining the audit procedures to be performed in light of the particular circumstances. Accordingly, this section is not intended to mandate auditing procedures to be applied in every audit of entities that undertake gaming and gaming related activities, nor is the discussion of management's responsibility for internal control intended to prescribe the types of controls to be implemented in all circumstances. Indeed, the types of controls required and the audit procedures performed by the independent auditor will vary depending on the nature of the entity's operations and the results of the auditor's consideration of the entity's internal control and assessment of the materiality of account balances and individual transactions in relation to the financial statements as a whole.

Client Acceptance and Engagement Organization

13.04 Examples of some industry-specific factors to consider during the client acceptance process for an existing gaming entity are as follows:

- Recent results of gaming regulatory examinations (for all jurisdictions).
- Compliance with federal currency transaction reporting and anti-money laundering regulations (for all jurisdictions).
- Auditor's knowledge, experience with the industry, including familiarity with the regulatory structure, as well as required regulatory procedures to be performed by the auditor.
- Gaming regulations, which require the auditor, in certain jurisdictions, to be licensed as a CPA in the state where the gaming

¹ Governmental gaming entities may include reports required by statute or other mandates to have their financial statements audited in accordance with *Government Auditing Standards* (also referred to as the Yellow Book), issue by the Comptroller General of the United States. In addition, auditors may hold themselves out as following *Government Auditing Standards*. The AICPA Audit Guide *Governmental Auditing Standards and Circular A-133 Audits* contains detailed guidance regarding *Government Auditing Standards*, including its eight financial reporting standards, in addition to those in generally accepted auditing standards (GAAS) in the United States.

entity is located or the CPA to be registered as an approved vendor with the regulatory body, or both. In addition, some state and tribal gaming regulators and tribal and state compacts include specific requirements for the licensing of CPAs.

- Legal and regulatory structure and environment, credibility and reputation of the gaming jurisdictions, commitment of regulators to the industry, history of gaming in the jurisdiction, licensure and renewal process for gaming operators, and other similar considerations of the overall climate and commitment to integrity in the jurisdiction.
- Timing, relative to the client's year end, of the change in auditors and its affect on the auditors' ability to satisfy himself regarding various cash balances as well as gaming liabilities that existed at year end.
- For regulatory and other reporting purposes, the auditors' ability to perform required internal control procedures during the period.

Scope of Services

13.05 The scope of services rendered by auditors generally depends on the types of reports to be issued as a result of the engagement. Paragraphs .08–.09 of AU section 311, *Planning and Supervision* (AICPA, *Professional Standards*), state that the auditor should establish an understanding with the client regarding the services to be performed for each engagement and should document the understanding through a written communication with the client. Such an understanding reduces the risk that either the auditor or the client may misinterpret the needs or expectations of the other party.

13.06 An understanding with the client may also include other matters, such as additional services to be provided relating to regulatory requirements, which may include reports on internal control, money laundering requirements, vendor requirements, and so forth. Such reports may be issued under the attestation or auditing standards of the AICPA *Professional Standards*.

Communications by Successor Auditors

13.07 AU section 315, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*), provides guidance on communication between predecessor and successor auditors when a change in auditors has taken place or is in process and provides communication guidance when possible misstatements are discovered in financial statements. Accordingly, the auditor may want to consider the following gaming-specific areas affecting the beginning balance sheet of a new client.

- Cash on hand
- Outstanding chip and token liabilities
- Progressive jackpot and other liabilities
- Wagering voucher accruals
- Customer loyalty program accruals and marketing programs
- Significant gaming receivables (markers)

- Accruals at year end for gaming revenue areas
- Race and sports *futures*² and *unpays*

Planning and Other Auditing Considerations

13.08 The objective of an audit of the gaming entity's financial statements is to express an opinion on whether its financial statements are presented fairly, in all material respects, its financial position, results of operations, and its cash flows—in conformity with generally accepted accounting principles in the United States (U.S. GAAP). To accomplish that objective, the independent auditor's responsibility is to plan and perform the audit to obtain reasonable assurance (a high, but not absolute, level of assurance) that material misstatements, whether caused by errors or fraud, are detected. This section addresses general planning considerations, assessment of risks of material misstatement, and other auditing considerations relevant to the gaming industry.

Audit Plan

13.09 The first standard of field work states, "The auditor must adequately plan the work and must properly supervise any assistants." AU section 311 establishes requirements and provides guidance to the auditor in accordance with GAAS on the considerations and activities applicable to planning and supervision, including preparing an audit plan, obtaining an understanding of the entity and its environment, and dealing with differences of opinion among firm personnel. Such considerations on activities involve appointment of the auditor; establishing an understanding with the client; preliminary engagement activities; preparing a detailed, written audit plan; determining the extent of involvement of professionals with specialized skills; and communicating with those charged with governance. Audit planning also involves developing an overall audit strategy for the expected conduct, organization, and staffing of the audit. The nature, timing, and extent of planning vary with the size and complexity of the entity and with the auditor's experience with the entity and understanding of the entity and its environment, including its internal control.

13.10 Paragraph .03 of AU section 311 states that the auditor must plan the audit so that it is responsive to the assessment of the risks of material misstatement based on the auditor's understanding of the entity and its environment, including its internal control. Planning is not a discrete phase of the audit, but rather an iterative process that begins with engagement acceptance and continues throughout the audit as the auditor performs audit procedures and accumulates sufficient appropriate audit evidence to support the audit opinion.

13.11 Audit planning specific to gaming may include the following considerations:

- Selection of the audit staff based on such criteria as experience in the industry, knowledge of gaming operations, and, if applicable, related hotel and food service knowledge. Consider providing training programs and briefing sessions.

² Terms that appear in the glossary are shown in *italics* the first time they appear.

- Plan on visiting and performing inspections and testing of the client's remote marketing offices and agents that hold cash and original receivable documents.
- Audit planning may take into consideration the types of promotional programs, such as coupon redemptions, *junkets*, promotional allowances, and other giveaway programs in use by the client and their significance.
- The reliance on internal audit.
- Consideration of the entity's regulatory requirements and the auditor's regulatory requirements.
- Utilization of systems and IT.
- Surprise and discrete observation of gaming operations, including cash counts.

Audit Risk

13.12 Paragraph .12 of AU section 312, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*), states that audit risk is a function of the risk that the financial statements prepared by management are materially misstated and the risk that the auditor will not detect such material misstatement. The auditor should consider audit risk in relation to the relevant assertions related to individual account balances, classes of transactions, and disclosures and at the overall financial statement level.

13.13 At the account balance, class of transactions, relevant assertion, or disclosure level, audit risk consists of (a) the risks of material misstatement (consisting of inherent risk and control risk) and (b) the detection risk. Paragraph .23 of AU section 312 states that auditors should assess the risk of material misstatement at the relevant assertion level as a basis to design and perform further audit procedures (tests of controls or substantive procedures). Therefore, auditors may not default to maximum control risk for an entity's risk assessment without documenting the basis for that assessment. This assessment may be in qualitative terms, such as high, medium, and low, or in quantitative terms, such as percentages.

13.14 In considering audit risk at the overall financial statement level, paragraph .15 of AU section 312 states that the auditor should consider risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many relevant assertions. Risks of this nature often relate to the entity's control environment and are not necessarily identifiable with specific relevant assertions at the class of transactions, account balance, or disclosure level. Such risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud, for example, through management override of internal control.

13.15 The following risk factors are inherent in the gaming environment:

- Technology and obsolescence
- Competition
- Laws, regulations, and taxation
- Turnover of key personnel
- Economic risk
- Labor relations

- Access to capital markets
- Adequacy of skilled personnel

Audit Assertions

13.16 Paragraphs .14–.19 of AU section 326, *Audit Evidence* (AICPA, *Professional Standards*), discuss the use of assertions in obtaining audit evidence. In representing that the financial statements are fairly presented in accordance with U.S. GAAP, management implicitly or explicitly makes assertions regarding the recognition, measurement, and disclosure of information in the financial statements and related disclosures. Assertions used by the auditor fall into the following categories.

Categories of Assertions

	<i>Description of Assertions</i>		
	<i>Classes of Transactions and Events During the Period</i>	<i>Account Balances at the End of the Period</i>	<i>Presentation and Disclosure</i>
Occurrence or existence	Transactions and events that have been recorded have occurred and pertain to the entity.	Assets, liabilities, and equity interests exist.	Disclosed events and transactions have occurred.
Rights and obligations	—	The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.	Disclosed events and transactions pertain to the entity.
Completeness	All transactions and events that should have been recorded have been recorded.	All assets, liabilities, and equity interests that should have been recorded have been recorded.	All disclosures that should have been included in the financial statements have been included.
Accuracy or valuation and allocation	Amounts and other data relating to recorded transactions and events have been recorded appropriately.	Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments are recorded appropriately.	Financial and other information is disclosed fairly and at appropriate amounts.
Cutoff	Transactions and events have been recorded in the correct accounting period.	—	—
Classification and understandability	Transactions and events have been recorded in the proper accounts.	—	Financial information is appropriately presented and described, and information in disclosures is expressed clearly.

13.17 According to paragraph .17 of AU section 326, the auditor should use relevant assertions for classes of transactions, account balances, and presentation and disclosures in sufficient detail to form a basis for the assessment of risks of material misstatement and the design and performance of further audit procedures. The auditor should use relevant assertions in assessing risks by considering the different types of potential misstatements that may occur and then designing further audit procedures that are responsive to the assessed risks.

Materiality

13.18 The auditor's consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of users of financial statements. Materiality judgments are made in light of surrounding circumstances and necessarily involve both quantitative and qualitative considerations.

13.19 In accordance with paragraphs .27–.28 of AU section 312, the auditor should determine a materiality level for the financial statements as a whole when establishing the overall audit strategy for the audit. The auditor often may apply a percentage to a chosen benchmark as a step in determining materiality for the financial statements as a whole.

13.20 The initial determination of materiality is made for the financial statement as a whole. However, the auditor should allow for the possibility that some misstatements of lesser amounts than the materiality levels could, in the aggregate, result in a material misstatement of the financial statements. To do so, the auditor should determine one or more levels of tolerable misstatement. Paragraph .34 of AU section 312 defines *tolerable misstatement* (or *tolerable error*) as the maximum error in a population (for example, the class of transactions or account balance) that the auditor is willing to accept. Such levels of tolerable misstatement are normally lower than the materiality levels.

13.21 As indicated previously, judgments about materiality include both quantitative and qualitative information. As a result of the interaction of quantitative and qualitative considerations in materiality judgments, misstatements of relatively small amounts that come to the auditor's attention could have a material effect on the financial statements. For example, an intentional underrecording of drop figures of an otherwise immaterial amount could be material if a reasonable possibility exists that it could lead to a material contingent liability or a material loss of revenue (for example, could result in a large fine from gaming regulators).

13.22 Qualitative considerations also influence the auditor in reaching a conclusion about whether misstatements are material. Paragraph .60 of AU section 312 provides qualitative factors that the auditor may consider relevant in determining whether misstatements are material.

Understanding the Entity, Its Environment, and Its Business

13.23 AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*), establishes standards and provides guidance about implementing the second standard of field work. Paragraph .01 of AU section 314 states that "the auditor must obtain a sufficient understanding of the entity and its environment,

including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures."

13.24 Obtaining an understanding of the entity and its environment, including its internal control, is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. Throughout this process, the auditor should also consider the guidance in AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*). For additional guidance pertaining to AU section 316, see paragraphs 13.65–.96.

13.25 The following are some unique aspects of the gaming industry that may be helpful to the auditor in developing the required understanding of the entity, its environment, and its internal control:

- Understanding the unique aspects of the gaming industry and potential problem areas that may exist, for example, experience has shown that a greater possibility of fraud exists in operations in which large amounts of cash are being handled.
- Familiarity with regulations and the reporting requirements of regulatory authorities, as well as authorities' involvement in the gaming entities' control environment, before fieldwork starts.
- Read recent communications with regulatory agencies. If 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 section 333, *Management Representations* (AICPA, *Professional Standards*), establishes a requirement that an auditor performing an audit in accordance with generally accepted auditing standards obtain written representations for all financial statements and periods covered by the auditor's report. AU section 333 also provides guidance concerning the representations to be obtained, along with an illustrative management representation letter. Management representations specific to gaming may include the following:
 - Compliance with gaming related rules and regulations
 - Communications from gaming regulatory authorities
- Regulations require many gaming entities to have internal audit functions. The auditor should be aware that the work of internal auditors in this industry may differ from that in other industries. A significant portion of the internal auditor's work involves observation of gaming activities.

13.26 AU section 314 establishes standards and provides guidance about implementing the second standard of field work. In accordance with paragraph .04 of AU section 314, the auditor should use professional judgment to determine the extent of the understanding required of the entity and its environment, including its internal control. The auditor's primary consideration is whether the understanding that has been obtained is sufficient (a) to assess risks of material misstatement of the financial statements, and (b) to

design and perform further audit procedures (for example, tests of controls and substantive tests).

13.27 The auditor's understanding of the entity and its environment consists of an understanding of the following aspects:

- a. Industry, regulatory, and other external factors
- b. Nature of the entity
- c. Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements
- d. Measurement and review of the entity's financial performance
- e. Internal control, which includes the selection and application of accounting policies (see chapter 15, "Internal Control," of this guide for further discussion)
- f. Customer base and markets that operate in them. Appendix A, "Understanding the Entity and Its Environment," of AU section 314 provides examples of matters that the auditor may consider in obtaining an understanding of the entity and its environment relating to the preceding categories.

13.28 In addition to an understanding of the industry, including matters such as those described in chapter 1, "Industry Overview," and chapter 3, "Overview of Gaming and Gaming Related Revenue," of this guide, the auditor should obtain an understanding of matters that are unique to the entity under audit. With regard to gaming, such matters include risk management strategies, organizational structure, capital structure, locations, and other operating characteristics. The auditor's knowledge of the gaming industry should be sufficient to provide an understanding of events, transactions, and practices that may have a significant effect on the financial statements. The auditor should also obtain an understanding of the operating segments of the business, as defined by Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 280-10-50.

13.29 An understanding of the entity may also be obtained or supplemented by reading documents, such as the following:

- The entity's charter and bylaws, code of conduct, and other governing material, or tribal or state gaming compact
- Minutes of meetings of the board of directors, audit committee, and other appropriate committees
- Prior-year and interim financial statements and other relevant reports, such as recently issued registration statements
- Organizational charts
- Operating policies
- Regulatory examination reports
- Internal audit reports
- Correspondence with regulators
- Marketing strategy
- Capital or business plans
- Internal reports and financial information utilized by management to make business decisions

Discussion Among the Audit Team

13.30 In obtaining an understanding of the entity and its environment, including its internal control, AU section 314 states that there should be discussion among the audit team. In accordance with paragraph .14 of AU section 314, the members of the audit team, including the auditor with final responsibility for the audit, should discuss the susceptibility of the entity's financial statements to material misstatements. This discussion could be held concurrently with the discussion among the audit team that is specified by AU section 316 to discuss the susceptibility of the entity's financial statements to fraud.

Industry Risk Factors

13.31 Auditors with clients in the gaming industry should obtain information about the general business and economic risk factors that affect the gaming industry. No list of risk factors covers all of the complex characteristics that affect transactions in the gaming industry. Some of those risk factors are discussed in paragraphs 13.70–.75. Appendix D, "Currency Transaction Reporting in the Gaming Industry," provides some common suspicious activities that may represent money laundering risk factors for gaming entities. Other primary risk factors are described in the following text. Auditors should obtain an understanding of such risk factors when planning the audit of a gaming entity or entity with gaming related activities.

Related Parties

13.32 Obtaining an understanding of a client's business should also include performing the procedures in AU section 334, *Related Parties* (AICPA, *Professional Standards*), to determine the existence of related-party relationships and transactions with such parties. The FASB ASC glossary defines *related parties* as

- a. affiliates³ of the entity (according to the FASB ASC glossary, an *affiliated entity* is an entity that directly or indirectly controls, is controlled by, or is under common control with another entity; also, a party with which the entity may deal if one party has the ability to exercise significant influence over the other's operating and financial policies as discussed in FASB ASC 323-10-15);
- b. entities for which investments in their equity securities would be required, absent the election of the fair value option under the "Fair Value" subsection of FASB ASC 825-10-15, to be accounted for by the equity method by the investing entity;
- c. trusts for the benefit of employees, such as pension and profit-sharing trusts, that are managed by or are under the trusteeship of management;
- d. principal owners of the entity and members of their immediate families;
- e. management of the entity and members of their immediate families;

³ Issuers refer to the Securities and Exchange Commission (SEC) Regulation S-X Rule 6-02(a) for the definition of an *affiliate*.

- f. other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests; and
- g. other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

13.33 Paragraph .02 of AU section 334 states that the auditor 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 generally will 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.⁴ If the gaming entity, or entity involved with gaming related activities, includes such a representation in the financial statements and the auditor believes that the representation is unsubstantiated by management, he or she should express a qualified or adverse opinion because of a departure from GAAP, depending on materiality.

Risk Assessment

13.34 As described in AU section 326, audit procedures performed to obtain an understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement at the financial statement and relevant assertion levels are referred to as *risk assessment procedures*. Paragraph .21 of AU section 326 states that the auditor must perform risk assessment procedures to provide a satisfactory basis for the assessment of risks at the financial statement and relevant assertion levels. Risk assessment procedures, by themselves, do not provide sufficient appropriate audit evidence on which to base the audit opinion and must be supplemented by further audit procedures in the form of tests of controls, when relevant or necessary, and substantive procedures.

13.35 According to paragraph .05 of AU section 314 and as described in AU section 326, audit procedures to obtain the understanding are referred to as risk assessment procedures because some of the information obtained by performing such procedures may be used by the auditor as audit evidence to support assessments of the risks of material misstatement. In addition, in performing risk assessment procedures, the auditor may obtain audit evidence about the relevant assertions related to classes of transactions, account balances, or disclosures and about the operating effectiveness of controls, even

⁴ Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 850-10-50-5 states that if representations are made about transactions with related parties, the representations should not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's length transactions unless such representations can be substantiated.

though such audit procedures were not specifically planned as substantive procedures or as tests of controls.

13.36 In accordance with paragraph .06 of AU section 314, the auditor should perform the following risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control:

- a. Inquiries of management and others within the entity
- b. Analytical procedures
- c. Observation and inspection

See paragraphs .06–.13 of AU section 314 for additional guidance on risk assessment procedures.

13.37 Risk assessment procedures allow the auditor to gather the information necessary to obtain an understanding of the entity and its environment, including its internal control. This knowledge provides a basis for assessing the risks of material misstatement of the financial statements. These risk assessments are then used to design further audit procedures, such as tests of controls, substantive tests, or both. This section provides guidance on assessing the risks of material misstatement and how to design further audit procedures that effectively respond to those risks.

Assessing the Risks of Material Misstatement

13.38 Paragraph .102 of AU section 314 states that the auditor should identify and assess the risks of material misstatement at the financial statement level and at the relevant assertion level related to classes of transactions, account balances, and disclosures. For this purpose, the auditor should

- a. identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and considering the classes of transactions, account balances, and disclosures in the financial statements.
- b. relate the identified risks to what can go wrong at the relevant assertion level.
- c. consider whether the risks are of a magnitude that could result in a material misstatement of the financial statements.
- d. consider the likelihood that the risks could result in a material misstatement of the financial statements.

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

- 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
- Estimated stock-based compensation expense
- 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

13.40 Paragraph .03 of AU section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AICPA, *Professional Standards*), states that in order to reduce audit risk to an acceptably low level, the auditor should determine overall responses to address the assessed risks of material misstatement at the financial statement level and should design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the relevant assertion level. (See paragraphs .04–.07 of AU section 318.) Paragraph .104 of AU section 314 states that the auditor should determine whether the identified risks of material misstatement relate to specific relevant assertions related to classes of transactions, account balances, and disclosures or whether they relate more pervasively to the financial statements as a whole and potentially affect many relevant assertions.

Identification of Significant Risks

13.41 As part of the assessment of the risks of material misstatement, the auditor should determine which of the risks identified are, in the auditor's judgment, risks that require special audit consideration (such risks are defined as *significant risks*). One or more significant risks normally arise on most audits. Paragraph .45 of AU section 318 states the greater the risks of material misstatement, the more audit evidence the auditor should obtain that controls are operating effectively. Accordingly, although the auditor should consider information obtained in prior audits in designing tests of controls to mitigate a significant risk, the auditor should not rely on audit evidence about the operating effectiveness of controls over such risks obtained in a prior audit, but instead should obtain audit evidence about the operating effectiveness of controls over such risks in the current period. Refer to paragraphs .45 and .53 of AU section 318.

Analytical Procedures Used in Risk Assessment

13.42 AU section 329, *Analytical Procedures* (AICPA, *Professional Standards*), establishes standards and provides guidance on the use of analytical procedures and requires the use of analytical procedures in the planning and overall review stages of all audits. For risk assessment purposes, such procedures focus on (a) enhancing the auditor's understanding of the institution's business and transactions and events that have occurred since the last financial statement audit, and (b) identifying areas that may present specific risks relevant to the financial statement audit. The objective of analytical procedures is to identify unusual transactions and events and amounts, ratios, and trends that might indicate matters that have financial statement and audit planning ramifications.

13.43 Analytical procedures used in risk assessment generally use data aggregated at a high level. The nature, extent, and timing of the procedures, which are based on the auditor's judgment, may vary widely depending on the size and complexity of the entity. The procedures may consist of reviewing changes in account balances from the prior year to the current year using the

general ledger or a preliminary or unadjusted working trial balance. Alternatively, the procedures may involve an extensive analysis of quarterly financial statements, ratios, statistics, and budgeted amounts, including their relationship to the performance of the industry as a whole. In either case, the analytical procedures, combined with the auditor's knowledge of the business, serve as a basis for additional inquiries and effective planning. Analytical procedures may also be used as substantive tests to identify potential misstatements. These procedures focus on comparing recorded amounts with expected balances and ratios and investigating and evaluating significant differences.

Understanding of Internal Control⁵

13.44 Management is responsible for establishing and maintaining effective internal control. The way in which internal control is designed and implemented varies with an entity's size and complexity. Some assets of a gaming entity are generally more negotiable and more liquid than those of other industries. As a result, they may be subject to greater risk of loss. In addition, the operations of gaming entity or entities involved in gaming related activities are characterized by a high volume of transactions; as a result, the effectiveness of internal control is a significant audit consideration. Refer to chapter 15 of this guide for a detailed discussion on internal control.⁶

13.45 Paragraph .40 of AU section 314 states that the auditor should obtain an understanding of the five components of internal control (see paragraph 13.48) sufficient to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. The auditor should obtain a sufficient understanding by performing risk assessment procedures to

- a. evaluate the design of controls relevant to an audit of financial statements, and
- b. determine whether they have been implemented.

13.46 The auditor should use such knowledge to

- identify types of potential misstatements.
- consider factors that affect the risks of material misstatement.
- design tests of controls, when applicable, and substantive procedures.

13.47 The objective of obtaining an understanding of controls is to evaluate the design of controls and determine whether they have been implemented for the purpose of assessing the risks of material misstatement. In contrast, the objective of testing the operating effectiveness of controls is to determine whether the controls, as designed, prevent, or detect and correct a material misstatement.

13.48 Paragraph .41 of AU section 314 explains that internal control is a process—effected by those charged with governance, management, and other

⁵ The AICPA's Technical Questions and Answers (TIS) section 8200, *Internal Control* (AICPA, *Technical Practice Aids*), provides guidance to auditors. For more information, please visit the AICPA website at www.aicpa.org.

⁶ This section discusses the consideration of internal control in a financial statement audit; it does not address reporting on a written management assertion about financial reporting controls.

personnel—designed to provide reasonable assurance regarding the achievement of the entity's objectives in (a) the reliability of financial reporting, (b) the effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.

13.49 Paragraph .41 of AU section 314 says that internal control consists of five interrelated components:

- a. *Control environment* sets the tone of an entity, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
- b. *Risk assessment* is the entity's identification and analysis of relevant risks to the achievement of its objectives, forming a basis for determining how the risks should be managed.
- c. *Control activities* are the policies and procedures that help ensure management directives are carried out.
- d. *Information and communication systems* support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- e. *Monitoring* is a process that assesses the quality of internal control performance over time.

13.50 Paragraph .48 of AU section 314 states that for significant risks, the auditor should evaluate the design of the entity's related controls, including relevant control activities, and determine whether they have been implemented. In exercising that judgment, the auditor should consider the circumstances, the applicable component, and factors, such as the following:

- a. Materiality
- b. The entity's size
- c. The entity's organization and ownership characteristics
- d. The diversity and complexity of the entity's operations
- e. Applicable legal and regulatory requirements
- f. The nature and complexity of the systems that are part of the entity's internal control, including the use of service organizations

13.51 Paragraph .48 of AU section 314 says that, ordinarily, controls that are relevant to an audit pertain to the entity's objective of preparing financial statements for external purposes that are fairly presented in conformity with GAAP or a comprehensive basis of accounting other than GAAP.

13.52 Paragraph .50 of AU section 314 states that the controls relating to operations and compliance objectives may be relevant to an audit if they pertain to data the auditor may evaluate or use in applying audit procedures. For example, controls pertaining to detecting noncompliance with laws and regulations that may have a direct and material effect on the financial statements, such as compliance with income tax laws and regulations used to determine the income tax provision, may be relevant to an audit.

13.53 An auditor may rely on controls to support a reduction in the assessed level of control risk. However, if the auditor is unable to obtain sufficient appropriate audit evidence about 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 their opinion accordingly. This scope limitation may exist even though procedures, such as analyses of variations in operating ratios, are used in auditing gaming entities (see chapter 16, "Analytical Procedures," of this guide for a detailed discussion on analytical procedures) because these procedures often do not provide sufficient audit evidence in the absence of effective controls over gaming revenues.

13.54 The auditor should perform tests of controls when the auditor's risk assessment includes an expectation of the operating effectiveness of controls or when substantive procedures alone do not provide sufficient appropriate audit evidence at the relevant assertion level.

13.55 Procedures to obtain audit evidence 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 should 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.

Considerations of Audits Performed in Accordance With PCAOB Standards

13.56 Regardless of the assessed level of control risk, the auditor should perform substantive procedures for all relevant assertions related to all significant accounts and disclosures in the financial statements. Refer to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Auditing Standards), for requirements and direction that applies when an auditor is engaged to perform an audit of management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements.

13.57 When a company reports material weaknesses in its internal control over financial reporting, management has the option to seek auditor agreement that the material weakness no longer exists prior to the next annual audit. Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist* (AICPA, *PCAOB Standards and Related Rules*, Auditing Standards), describes the steps to be used by auditors when a company voluntarily engages them to report on whether a previously disclosed material weakness no longer exists.

13.58 The main objective for auditors performing an engagement in accordance with Auditing Standard No. 4 is to obtain a reasonable assurance about whether the previously reported material weakness still exists. The work performed by the auditor focuses on whether controls specified by management are operating effectively to properly address the material weakness, as of a specified date by management.

IT Considerations

13.59 Many aspects of a gaming entity'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 server-based gaming systems.

13.60 A gaming entity's operations are characterized by large volumes of transactions and, therefore, generally rely heavily on computers. AU section 314 and AU section 326 establish standards and provide guidance for auditors who have been engaged to audit an entity's financial statements when significant information is transmitted, processed, maintained, or accessed electronically.

13.61 An entity's use of IT may affect any of the five components of internal control relevant to the achievement of the entity's financial reporting, operations, or compliance objectives, and its operating units or business functions. The auditor might consider matters such as

- the extent to which IT is used for significant accounting applications;
- the complexity of the gaming entity's IT, including whether outside service organizations are used;
- the organizational structure for IT, including the extent to which online terminals and networks are used;
- the physical security controls over computer equipment;
- controls over IT (for example, program changes and access to data files), operations, and systems;
- the availability of data; and
- the use of IT-assisted audit techniques to increase the efficiency and effectiveness of performing procedures. (Using IT-assisted audit techniques may also provide the auditor with an opportunity to apply certain procedures to an entire population of accounts or transactions. In addition, in some accounting systems, it may be difficult or impossible for the auditor to analyze certain data or test specific control procedures without IT assistance.)

13.62 Some of the accounting data and corroborating audit evidence may be available only in electronic form. For example, entities may use electronic data interchange or image processing systems. In image processing systems, documents are scanned and converted into electronic images to facilitate storage and reference, and the source documents may not be retained after conversion. Certain electronic evidence may exist at a certain point in time. However, such evidence may not be retrievable after a specified period of time if files are changed and if backup files do not exist. Therefore, the auditor might consider the time during which information exists or is available in determining the nature, timing, and extent of their substantive tests and, if applicable, tests of controls.

13.63 IT techniques may be performed solely by the gaming entity, shared with others, or provided by an independent organization supplying specific data processing services for a fee. AU section 324, *Service Organizations* (AICPA, *Professional Standards*), establishes standards and provides guidance on the factors that an auditor should consider when auditing the financial statements

of entities that obtain services that are part of its information system from another organization.

*Considerations for Audits Performed in Accordance With PCAOB Standards**

Paragraph .01 of AU section 324, *Service Organizations* (AICPA, *PCAOB Standards and Related Rules*, Interim Standards), states that when performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs B17–B27 of appendix B, "Special Topics," of Auditing Standard No. 5.

13.64 The auditor should consider whether specialized skills are needed to consider the effect of IT on the audit, to understand the internal control, or to design and perform audit procedures. If specialized skills are needed, the auditor should seek the assistance of someone possessing such skills that may be either on the audit staff or an outside professional. If the use of such a professional is planned, the auditor should have sufficient IT-related knowledge to communicate the desired objectives to the IT professional to evaluate whether the specific procedures will meet the auditor's objectives and to evaluate the results of the procedures applied as they relate to the nature, timing, and extent of other planned audit procedures.

13.65 System upgrades, conversions, and changes in technology have occurred with increasing frequency in the industry to accommodate the many changes in the nature and complexity of games offered, ongoing changes in accounting rules, continually evolving regulations, and mergers and acquisitions. A number of system changes may affect internal control. For example, merging gaming entities with incompatible computer systems can have a significant negative impact on the surviving gaming entity's internal control. In addition to obtaining the understanding of ongoing or planned changes in processing controls that is necessary to plan the audit, the auditor may find it necessary to consider the effect of system changes on

- a. controls over the accurate conversion of data to new or upgraded systems;
- b. the effectiveness of data provided to perform analyses, such as those of the entity's performance versus its plan for asset-liability management; and
- c. the adequacy of the entity's disaster recovery plan and system.

13.66 Large volumes of gaming transactions are processed over short periods of time. Demands placed on both computerized and manual systems can be great. These demands increase the risks that the accuracy and timeliness of related information could be misstated. Some related considerations are described in chapter 15.

* In August 2010, the Public Company Accounting Oversight Board (PCAOB) issued Release No. 2010-004, *Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards*. With this release, the PCAOB adopted eight auditing standards related to the auditor's assessment of, and response to, risk that will supersede six of the board's interim auditing standards and related amendments to PCAOB standards. These standards are effective for audit engagements conducted pursuant to the standards of the PCAOB for fiscal years beginning on or after December 15, 2010. Refer to the preface of this guide for important information about the release and applicability of these standards. Readers can download the entire release, which includes full text of the standards, at www.pcaobus.org.

Consideration of Fraud in a Financial Statement Audit

Introduction

13.67 AU section 316 is the primary source of authoritative guidance about an auditor's responsibilities concerning the consideration of fraud in a financial statement audit. AU section 316 establishes standards and 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 paragraph .02 of AU section 110, *Responsibilities and Functions of the Independent Auditor* (AICPA, *Professional Standards*).

Considerations for Audits Performed in Accordance With PCAOB Standards

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with Public Company Accounting Oversight Board (PCAOB) standards, refer to paragraphs 14–15 of Auditing Standard No. 5 regarding fraud considerations, in addition to the fraud considerations set forth in AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *PCAOB Standards and Related Rules*, Interim Standards).

13.68 Two types of misstatements are 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

13.69 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.

13.70 *The importance of exercising professional skepticism.* Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the risks of material misstatement due to fraud. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. According to paragraph .13 of AU section 316, 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.

13.71 *Discussion among engagement personnel regarding the risks of material misstatement due to fraud.*⁷ Members of the audit team should discuss

⁷ The brainstorming session to discuss the entity's susceptibility to material misstatements due to fraud could be held concurrently with the brainstorming session required under AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*), to discuss the potential of the risk of material misstatement.

the potential for material misstatement due to fraud in accordance with the requirements of paragraphs .14–.18 of AU section 316. The objective of the discussion is for members of the audit team to gain a better understanding of the potential for material misstatements of the financial statements resulting from fraud or error in the specific areas assigned to them and to understand how the results of the audit procedures that they perform may affect other aspects of the audit, including the decisions about the nature, timing, and extent of further audit procedures. The discussion provides an opportunity for more experienced team members, including the auditor with final responsibility for the audit, to share their insights based on their knowledge of the entity, and for the team members to exchange information about the business risks to which the entity is subject and about how and where the financial statements might be susceptible to material misstatement. As specified in AU section 316, particular emphasis should be given to the susceptibility of the entity's financial statements to material misstatement due to fraud. In addition, the audit team should discuss critical issues, such as areas of significant audit risk; areas susceptible to management override of controls; unusual accounting procedures used by the client; important control systems; materiality at the financial statement level and at the account level; and how materiality will be used to determine the extent of testing. The discussion should also address application of GAAP to the entity's facts and circumstances and in light of the entity's accounting policies. The following is a list of fraud risk factors that auditors may consider as part of their planning and audit procedures. The purpose is for audit team members to communicate and share information obtained throughout the audit that may affect the assessment of the risks of material misstatement due to fraud or error or the audit procedures performed to address the risks.

13.72 The following are examples of risk factors that might result in misstatements arising from fraudulent financial reporting.

Incentives or Pressures

13.73 Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by) the following:

- a. High degree of competition or market saturation, accompanied by narrowing margins
- b. High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates, exemplified by the following:
 - i. A failure or inability to keep pace with or to afford rapid changes in technology, if the financial stability or profitability of the gaming entity is placed at risk due to that failure or inability
 - ii. Significant unexpected volatility (for example, in interest rates, foreign exchange rates, and commodity prices)
- c. Significant declines in customer demand and increasing business failures in either the industry or overall economy, such as the following:
 - i. Deteriorating economic conditions (for example, driven by a high degree of competition or market competition, such

as a neighboring jurisdiction legalizes gaming) within industries or geographic regions

- d.* Rapid growth or unusual profitability, especially compared to that of other peer gaming entities
- e.* New and existing accounting, statutory, or regulatory requirements
- f.* Decline in asset quality due to borrowers affected by recessionary declines and layoffs, issuers affected by recessionary declines and industry factors, not reinvesting money into the gaming property

13.74 Management or operating personnel is under excessive pressure to meet financial targets set up by those charged with governance or management, including incentive goals.

13.75 Management's or those charged with governance's personal net worth is threatened by the entity's financial performance.

Opportunities

13.76 The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- a.* Significant related entity transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- b.* Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- c.* Significant, unusual, or highly complex transactions, especially those close to year end that pose difficult "substance over form" questions.
- d.* Judgmental reserves and accruals, including bad debts, tax contingencies, and health insurance accruals. These accounts require significant estimates and assumptions and can be manipulated through nonrecurring, period-end journal entries.
- e.* Large quantities of cash that remains unrecorded for an extended period of time.
- f.* Decentralized operations. Many entities operate multiple gaming facilities in various locations. In many cases, significant operating authority is delegated to local management. In some cases, gaming entities have foreign operations as well. Lack of central control or proper monitoring procedures can increase the risk of fraud.
- g.* Lack of emphasis given to ancillary lines of business.
- h.* 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 gaming entities.

- 13.77** Internal control components are deficient as a result of the following:
- a. Inadequate monitoring of controls, including automated controls and controls over financial reporting, such as lack of oversight of critical processes in the following areas:
 - i. Cash and banks—reconciliation and review
 - ii. Proper counting, reconciliation, and review, including reserve chip inventory
 - b. Ineffective internal audit function
 - c. Vacant staff positions remain unfilled for extended periods, thereby preventing the proper segregation of duties
 - d. Inadequate accounting reconciliation policies and practices, including appropriate supervisory review, the monitoring of stale items and out of balance conditions, and the timeliness of writeoffs
 - e. Failure to establish adequate segregation of duties between approval transactions and the disbursement of funds
 - f. Lack of control over the regulatory reporting process
 - g. Lack of adequate reporting to the board of directors and executive management

Attitudes and Rationalizations

13.78 Risk factors reflective of attitudes or rationalizations by those charged with governance, management, or employees that allow them to engage in or justify, or both, fraudulent financial reporting may not be susceptible to observation by the auditor. Nevertheless, the auditor who becomes aware of the existence of such information might consider it in identifying the risks of material misstatement arising from fraudulent financial reporting. For example, auditors may become aware of the following information that may indicate a risk factor:

- a. Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or board members alleging fraud or violations of laws and regulations:
 - i. The existence of a regulatory cease and desist order, memorandum of understanding, or other regulatory agreements (whether formal or informal), which concern management competence or internal control
 - ii. Repeated criticisms or apparent violations cited in regulatory examination reports, which management has ignored
- b. Nonfinancial management's excessive participation in, or preoccupation with, the selection of accounting principles or the determination of significant estimates:
 - i. Consideration of "business issues" (for example, shareholder expectations) in determining significant estimates
 - ii. An unusual propensity to enter into complex asset disposition agreements
- c. The disregard of control-related recommendations from internal or external auditors, or both.

- d. A high level of customer complaints (especially when management does not fix the cause of them promptly).
- e. Internal audit indications that the internal audit is not adequately staffed or trained and does not have appropriate specialized skills given the environment:
 - i. Indications that the internal audit is not independent (authority and reporting relationships) and does not have adequate access to the audit committee (or equivalent)
 - ii. Inappropriate scope of internal audit's activities (for example, the balance between financial and operational audits, coverage, and rotation of decentralized operations)
 - iii. Limited authority of internal audit to examine all aspects of the client's operations or failure to exercise its authority
 - iv. Failure by internal audit to adequately plan, perform risk assessments, or document the work performed or conclusions reached
- f. Failure of internal audit to adhere to professional standards.
- g. Operating responsibilities assigned to internal audit.
- h. Inability to prepare accurate and timely financial reports, including interim reports.
- i. Failure of planning and reporting systems (such as business planning; budgeting, forecasting, and profit planning; and responsibility accounting) to adequately set forth management's plans and the results of actual performance.
- j. A low level of user satisfaction with information systems processing, including reliability and timeliness of reports.
- k. Understaffed accounting or IT department, inexperienced or ineffective accounting or IT personnel, or high turnover.
- l. Lack of timely and appropriate documentation for transactions.
- m. Issuance of credit and complimentaries to customers may indicate the possibility of employee kickbacks.
- n. A large number of vendors with fungible products exist.

Misappropriation of Assets

13.79 An auditor's interest specifically relates to fraudulent acts that cause a material misstatement of financial statements. Some of the following factors and conditions are present in entities in which specific circumstances *do not present a risk of material misstatement*. Also, specific controls may exist that mitigate the risks of material misstatement due to fraud, even though risk factors or conditions are present. When identifying risk factors and other conditions, the auditor could assess whether those risk factors and conditions, individually and in combination, present risks of material misstatement of the financial statements.

13.80 Risk factors that relate to misstatements arising from the misappropriation of assets are also classified along the three conditions generally present when fraud exists, namely, incentives or pressures, opportunity, and attitudes or rationalizations. Some of the risk factors related to misstatements

arising from fraudulent financial reporting also may be present if misstatements arising from misappropriation of assets occur. For example, the ineffective monitoring of management and weakness in internal control may be present if misstatements due to either fraudulent financial reporting or the misappropriation of assets exist. The following sections show examples of risk factors related to misstatements arising from misappropriation of assets.

13.81 AU section 316 does not require an auditor to plan the audit to discover information that indicates financial stress among employees or adverse relationships between the gaming entity and its employees. If the auditor becomes aware of the existence of such information, he or she might consider it in addressing the risks of material misstatement arising from the misappropriation of assets:

- a. Adverse relationships between the gaming entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, the following may create adverse relationships:
 - i. It is likely that the gaming entity will be merged into or acquired by another gaming entity and there is uncertainty regarding the employees' future employment opportunities.
 - ii. The gaming entity has recently completed a merger or acquisition, employees are working long hours on integration projects, and morale is low.
 - iii. The gaming entity is under regulatory scrutiny, and there is uncertainty surrounding its future.
- b. Members of executive management evidence personal financial distress through indications such as frequent informal "loans" or "salary advances" to key executive officers or their family members.

13.82 *Opportunities for the misappropriation of assets.* Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when the following exist:

- a. Large amounts of cash on hand and wire transfer capabilities
- b. Inadequate or ineffective physical security controls, for example, over liquid assets or information systems
- c. Access to customer accounts

13.83 Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, the misappropriation of assets may occur because the following exist:

- a. Inadequate management oversight of employees responsible for assets, such as the following:
 - i. The independent risk management function does not have the appropriate level of sophistication or the capability to effectively monitor and measure the risks.
 - ii. Lack of adherence or enforcement of vacation policy.
- b. Inadequate job applicant screening or monitoring, or both, of employees, such as the following:

- i. Background checks, credit reports, and bonding eligibility screening are not incorporated into the hiring process for employees with access to significant assets susceptible to misappropriation.
- ii. A monitoring process does not identify employees who have access to assets susceptible to misappropriation and who are known to have financial difficulties.
- c. Inadequate segregation of duties and independent checks
- d. Poor physical safeguards over cash, investments, customer information, or fixed assets:
 - i. Failure to appropriately limit access to the cage to authorized employees acting within the scope of their job

Obtaining Information About Fraud Risks

13.84 AU section 314 provides guidance about an auditors' understanding of the entity and its environment, including its internal control. 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–.42 of AU section 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–.27 of AU section 316.)
- b. Consider any unusual or unexpected relationships that have been identified in performing analytical procedures in planning the audit. (See paragraphs .28–.30 of AU section 316.)
- c. Consider whether one or more fraud risk factors exist. (See the appendix "Examples of Fraud Risk Factors" in AU section 316.)
- d. Consider other information that may be helpful in the identification of risks of material misstatement due to fraud. (See paragraph .34 of AU section 316.)

13.85 When performing 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 in the gaming industry, the following analytical procedures may be useful in identifying areas for further investigation:

- a. Unusually high or low revenue growth compared to market revenue growth
- b. Cash flow or operating margins that are flat or declining during periods of revenue growth
- c. Changes in the ratio of provision for doubtful accounts to markers issued, changes in bad debt allowance percentages, or changes in days' sales outstanding
- d. Unusual table games or slots win percentages over a sustained period
- e. Unusually high operating growth margin
- f. Unusual marker collection rate percentages

13.86 *Considering fraud risk factors.* As indicated in paragraphs 13.71–.73, the auditor may identify events or conditions that indicate incentives or pressures to perpetrate fraud, opportunities to carry out the fraud, or attitudes or 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 in which fraud exists.

13.87 AU section 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 types of information an auditor considers when identifying and assessing risk of material misstatement due to fraud.

13.88 *Identifying risks that may result in a material misstatement due to fraud.* 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–.34 of AU section 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. Some examples for gaming entities may include the following:

- a. *Property and equipment accounting.* Fixed assets tend to be the largest asset for gaming entities, and although the primary gaming entities' building assets are highly visible, the costs of the buildings and related equipment can be manipulated. Whether specific types of costs qualify for capitalization is an issue for some expenditures. Determinations of whether expenditures are capital in nature or repairs and maintenance must be made on a regular basis. A small change in estimated useful lives can cause significant changes in reported income. In many cases, it can be difficult to maintain detailed fixed asset records, increasing the potential for fraud related to disposal of assets, and management's decisions and judgments are of particular importance when addressing impairments of property and equipment.
- b. *Bad debt reserves.* Receivables generated through *marker play* can be a significant asset for gaming entities. The collectability of such accounts is subject to many risks, some of which are typical among all trade receivables, and some of which are unique. Individual accounts can be quite large, increasing the need for specific credit and collectability analysis, instead of a percentage-based approach. This assessment involves significant management judgment. Many customers are foreign and deal directly with *independent agents*, causing the gaming entity to lose some oversight ability.
- c. *Subjective accrued liabilities.* Accounts such as chip float accruals, loyalty programs, accrued health insurance (if self-insured), tax contingencies, and accrued legal liabilities are all subject to

significant judgment and are part of nonroutine transaction processing performed by higher levels of management.

- d. 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 changing technology.
- e. Slot technology is constantly changing, increasing the risk of manipulation because new processes may not be well understood or properly controlled because those reviewing the results of transaction processing may not have extensive knowledge of new processes.

13.89 *A presumption that improper revenue recognition is a fraud risk.* 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). As such, an auditor should ordinarily presume that there is a risk of material misstatement due to fraud relating to revenue recognition. (See paragraph .54 of AU section 316).⁸ However, factors which may alleviate portions of the risk when considering material misstatements due to fraud in the area of revenue recognition for gaming entities are as follows:

- a. Gaming revenue typically consisting of large numbers of individually small transactions.
- b. Typically, no timing or cut-off issues in connection with the revenue transactions, such as those that may exist in other industries.
- c. Gaming revenue is not inherently complex, and no complex contracts or other judgmental elements are typically present.

13.90 *A consideration of the risk of management override of controls.* Even if specific risks of material misstatement due to fraud are not identified by the auditor, a possibility exists that management override of controls could occur, and accordingly, the auditor should address that risk in accordance with paragraph .57 of AU section 316 apart from any conclusions regarding the existence of more specifically identifiable risks. Specifically, the procedures described in paragraphs .58–.67 of AU section 316 should be performed to further address the risk of management override of controls. These procedures include (a) examining journal entries and other adjustments for evidence of possible material misstatement due to fraud, (b) reviewing accounting estimates for biases that could result in material misstatement due to fraud, and (c) evaluating the business rationale for significant unusual transactions.

13.91 *Assessing the identified risks after taking into account an evaluation of the entity's programs and controls that address the risks.* Auditors should comply with the requirements of paragraphs .43–.45 of AU section 316 concerning an entity's programs and controls that address identified risks of material misstatement due to fraud. The auditor should evaluate whether such programs and controls mitigate the identified risks of material misstatement

⁸ For a discussion of indicators of improper revenue recognition and common techniques for overstating revenue and illustrative audit procedures, see the AICPA Audit Guide *Auditing Revenue in Certain Industries*.

due to fraud or whether specific control deficiencies 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. Some examples of programs and controls in the gaming industry are described in chapter 15 of this guide.

13.92 *Responding to the results of the assessment.* Paragraphs .46–.67 of AU section 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 section 316.)
- b. A response to identified risks involving the nature, timing, and extent of the auditing procedures to be performed. (See paragraphs .51–.56 of AU section 316.)
- c. A response involving the performance of certain procedures to further address the risks of material misstatement due to fraud involving management override of controls, given the unpredictable ways in which such override could occur. (See paragraphs .57–.67 of AU section 316.)

13.93 *Evaluating audit evidence.* Paragraphs .68–.78 of AU section 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 previously unrecognized risks 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 audit evidence accumulated during the audit.

13.94 AU section 318 states the auditor should conclude whether sufficient appropriate audit evidence has been obtained to reduce to an appropriately low level the risks of material misstatement in the financial statements. In developing an opinion, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the relevant assertions in the financial statements.

13.95 Paragraph .74 of AU section 316 states at or near the completion of fieldwork, the auditor should evaluate whether the accumulated results of auditing procedures and other observations (for example, conditions and analytical relationships noted in paragraphs .69–.73 of AU section 316) affect the assessment of the risks of material misstatement due to fraud made earlier in the audit. This evaluation primarily is a qualitative matter based on the auditor's judgment. Such an evaluation may provide further insight about the risks of material misstatement due to fraud and whether a need exists to perform additional or different audit procedures. 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.

13.96 *Responding to misstatements that may be the result of fraud.* Paragraph .75 of AU section 316 states when audit test results identify misstatements in the financial statements, the auditor should consider whether such misstatements may be indicative of fraud. That determination affects the auditor's evaluation of materiality and the related responses necessary as a result of that evaluation. Furthermore, paragraph .76 of AU section 316 states 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. For example, fraud involving misappropriations of cash from a small petty cash fund normally would be of little significance to the auditor in assessing the risk of material misstatement due to fraud because both the manner of operating the fund and its size would tend to establish a limit on the amount of potential loss, and the custodianship of such funds normally is entrusted to a nonmanagement employee. Conversely, if the matter involves higher level management, even though the amount itself is not material to the financial statements, it may be indicative of a more pervasive problem, for example, implications about the integrity of management. In such circumstances, the auditor should reevaluate the assessment of the risks of material misstatement due to fraud and the resulting impact on (a) the nature, timing, and extent of the tests of balances or transactions, and (b) the assessment of the effectiveness of controls if control risk was assessed below the maximum.

13.97 Paragraph .77 of AU section 316 states 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 audit evidence 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.⁹
- b. consider the implications for other aspects of the audit. (See paragraph .76 of AU section 316.¹⁰)
- 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.
- d. if appropriate, suggest that the client consult with legal counsel.

13.98 Paragraph .78 of AU section 316 states 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 those charged with governance. The auditor

⁹ If the auditor believes senior management may be involved, discussion of the matter directly with those charged with governance may be appropriate.

¹⁰ See AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*), for guidance on auditors' reports issued in connection with audits of financial statements.

may wish to consult with legal counsel when considering withdrawal from an engagement.

13.99 *Communicating about possible fraud to management, those charged with governance, and others.* Paragraph .79 of AU section 316 states 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. This is appropriate even if the matter might be considered inconsequential, such as a minor defalcation by an employee at a low level in the entity's organization. Fraud involving senior management and fraud (whether caused by senior management or other employees) that causes a material misstatement of the financial statements should be reported directly to those charged with governance. See paragraphs .79–.82 of AU section 316 for further requirements and guidance about communications with management, the audit committee, and others.

13.100 *Documenting the auditor's consideration of fraud.* Paragraph .83 of AU section 316 establishes requirements and provides guidance on certain items and events to be documented by the auditor.

Compliance With Laws and Regulations

13.101 Paragraph .01 of AU section 314 states that the auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. In performing an audit of financial statements, the auditor considers government regulations in light of how they might affect the financial statement assertions.

13.102 AU section 317, *Illegal Acts by Clients* (AICPA, *Professional Standards*), prescribes the nature and extent of the auditor's consideration of the possibility of illegal acts by a client in an audit of financial statements in accordance with GAAS.

13.103 The term *illegal acts* refers to violations of laws or governmental regulations. Illegal acts vary considerably in their relation to the financial statements. The auditor's responsibility to detect and report misstatements resulting from illegal acts is dependent on the relationship between the law or regulation that is violated and the financial statements.

13.104 Some laws and regulations have a direct and possibly 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 related to the terms of trying to enter 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, the Annunzio-Wiley Anti-Money Laundering Act in 1992, the Money Laundering Suppression Act of 1994, and the USA PATRIOT Act of 2001

13.105 Money laundering is far less likely to affect financial statements than other types of fraud, such as misappropriation of assets, and consequently, is unlikely to be detected in a financial statement audit. Because money laundering involves the manipulation of large quantities of illicit proceeds and distancing them from their original source, these activities may have indirect effects on an entity's financial statements. For additional money laundering information, refer to appendix D.

13.106 The ultimate responsibility for compliance with laws and regulations rests with management of the gaming entity. According to paragraph .07 of AU section 317, the auditor should be aware of the possibility that such illegal acts may have occurred. According to paragraph .08 of AU section 317, procedures applied for the purpose of forming an opinion on the financial statements may bring possible illegal acts to the auditor's attention. For example, such procedures include reading minutes; inquiring of the client's management and legal counsel concerning litigation, claims, and assessments; and performing substantive tests of details of transactions or balances. The auditor should make inquiries of management concerning the client's compliance with laws and regulations. Normally, an audit in accordance with GAAS does not include audit procedures specifically designed to detect illegal acts.

Audit Performance and Execution

Designing and Performing Further Audit Procedures

13.107 AU section 318 established standards and provides guidance about implementing the third standard of field work, as follows: "The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit."

13.108 Paragraph .03 of AU section 318 states that in order to reduce audit risk to an acceptably low level, the auditor should determine overall responses to address the assessed risks of material misstatement at the financial statement level and should design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the relevant assertion level. The overall responses and the nature, timing, and extent of the further audit procedures to be performed are matters for the professional judgment of the auditor and described in greater detail in paragraphs .61–.68 of AU section 318.

13.109 The auditor's overall responses to address the assessed risks of material misstatement at the financial statement level may include emphasizing to the audit team the need to maintain professional skepticism in gathering and evaluating audit evidence, assigning more experienced staff or those with specialized skills or using specialists, providing more supervision, or incorporating additional elements of unpredictability in the selection of further audit procedures to be performed. Additionally, the auditor may make general changes to the nature, timing, or extent of further audit procedures as an overall response, for example, performing substantive procedures at period end instead of at an interim date.

13.110 Further audit procedures provide important audit evidence to support an audit opinion. These procedures consist of tests of controls and substantive tests. Paragraph .07 of AU section 318 states that the auditor

should design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the relevant assertion level.

13.111 Paragraph .08 of AU section 318 states, in part, that in some cases, the auditor may determine that performing only substantive procedures is appropriate for specific relevant assertions and risks. In those circumstances, the auditor may exclude the effect of controls from the relevant risk assessment. This may be because the auditor's risk assessment procedures have not identified any effective controls relevant to the assertion or because testing the operating effectiveness of controls would be inefficient. However, the auditor needs to be satisfied that performing only substantive procedures for the relevant assertions would be effective in reducing detection risk to an acceptably low level. The auditor often will determine that a combined audit approach using both tests of the operating effectiveness of controls and substantive procedures is an effective audit approach.

13.112 The auditor should perform tests of controls when the auditor's risk assessment includes an expectation of the operating effectiveness of controls¹¹ or when substantive procedures alone do not provide sufficient appropriate audit evidence at the relevant assertion level. When, in accordance with paragraph .117 of AU section 314, the auditor has determined that it is not possible or practicable to reduce the detection risks at the relevant assertion level to an acceptably low level, with audit evidence obtained only from substantive procedures, he or she should perform tests of controls to obtain audit evidence about their operating effectiveness. Tests of the operating effectiveness of controls are performed only on those controls that the auditor has determined are suitably designed to prevent or detect a material misstatement in a relevant assertion.

13.113 Testing the operating effectiveness of controls is different from obtaining audit evidence that controls have been implemented. When obtaining audit evidence of implementation by performing risk assessment procedures, the auditor should determine that the relevant controls exist and that the entity is using them. When performing tests of controls, the auditor should obtain audit evidence that controls operate effectively. This includes obtaining audit evidence about how controls were applied at relevant times during the period under audit, the consistency with which they were applied, and by whom or by what means they were applied. If substantially different controls were used at different times during the period under audit, the auditor should consider each separately. The auditor may determine that testing the operating effectiveness of controls at the same time as evaluating their design and obtaining audit evidence of their implementation is efficient.

13.114 Although some risk assessment procedures that the auditor performs to evaluate the design of controls and to determine that they have been implemented may not have been specifically designed as tests of controls, they may, nevertheless, provide audit evidence about the operating effectiveness

¹¹ TIS section 8200.06, "The Meaning of Expectation of the Operating Effectiveness of Controls" (AICPA, *Technical Practice Aids*), states that the phrase *expectation of the operating effectiveness of controls* means that the auditor's understanding of the 5 components of internal control has enabled him or her to initially assess control risk at less than maximum, and the auditor's strategy contemplates a combined approach of designing and performing tests of controls and substantive procedures.

of the controls and, consequently, serve as tests of controls. In such circumstances, the auditor should consider whether the audit evidence provided by those audit procedures is sufficient.

13.115 Substantive procedures are performed to detect material misstatements at the relevant assertion level and include tests of details of classes of transactions, account balances, and disclosures and substantive analytical procedures. The auditor should plan and perform substantive procedures to be responsive to the related assessment of the risks of material misstatement.

13.116 Regardless of the assessed risks of material misstatement, the auditor should design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure.

13.117 The auditor's substantive procedures should include the following audit procedures related to the financial statement reporting process:

- Agreeing the financial statements, including their accompanying notes, to the underlying accounting records
- Examining material journal entries and other adjustments made during the course of preparing the financial statements

The nature and extent of the auditor's examination of journal entries and other adjustments depend on the nature and complexity of the entity's financial reporting system and the associated risks of material misstatement.

Timing of Audit Procedures

13.118 The nature, timing, and extent of the audit procedures to be performed and the resulting reports to be issued are determined by the auditor based on a number of factors, including the consideration of regulatory restrictions and requirements on the timing of the audit. The auditor may determine that a significant amount of the audit can be performed at an interim date.

13.119 Tests of controls over accountability and gaming revenue should be performed periodically during the year. Generally, these audit procedures include observations of compliance with controls, such as those relating to the cage, count rooms, *pit*, and other gaming operating procedures. Specifically, these audit procedures might include the observation of

- the collection of drop boxes, drop buckets, and slot machine bill acceptors;
- cage and count room procedures;
- fill, credit, and marker procedures; and
- other gaming procedures.

13.120 The observation of the cash count, the principal substantive test regarding existence of cash, generally may be done as of the balance sheet date, but may be performed at an earlier or later time. If the observation is done at an interim date, the auditor should perform substantive procedures 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 procedures. (See AU section 314.)

13.121 In normal circumstances, when an auditor is appointed to perform an audit close to an entity'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 gaming entity, retroactive satisfaction about compliance with certain controls, particularly those relating to gaming revenues, may not be obtainable. 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. Refer to chapter 14, "Special Auditing Considerations," of this guide for additional special auditing considerations.

Analytical Procedures Used in Audit Performance

13.122 Analytical procedures involve the comparison of recorded amounts or ratios developed from recorded amounts with expectations developed by the auditor. The objective of analytical procedures used in the overall review stage of the audit is to assist the auditor in assessing the conclusions reached and in the evaluation of the overall financial statement presentation.

13.123 Paragraph .22 of AU section 329 contains the following documentation guidance for substantive analytical procedures:

When an analytical procedure is used as the principal substantive test of a significant financial statement assertion, the auditor should document all of the following:

- a. The expectation, when that expectation is not otherwise readily determinable from the documentation of the work performed and factors considered in its development
- b. Results of the comparison of the expectation to the recorded amounts or ratios developed from recorded amounts
- c. Any additional auditing procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures

13.124 The auditor considers the level of assurance, if any, he or she wants from substantive testing for a particular audit objective and then decides which procedure, or combination of procedures, can provide that level of assurance. Paragraph .11 of AU section 329 states that the effectiveness and efficiency of an analytical procedure in identifying potential misstatements depends on, among other things, (a) the nature of the assertion, (b) the plausibility and predictability of the relationship, (c) the availability and reliability of the data used to develop the expectation, and (d) the precision of the expectation. For this reason, substantive analytical procedures alone are not well suited to detecting fraud. In addition, before using results obtained from substantive analytical procedures, the auditor might 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.

13.125 For significant risks of material misstatement in an audit, it is unlikely that audit evidence obtained from substantive analytical procedures alone will be sufficient.

13.126 For detailed examples of analytical procedures that may be useful to auditors in obtaining an understanding of gaming and gaming related activities, refer to chapter 16 of this guide.

Audit Documentation—Audits Conducted in Accordance With GAAS

13.127 AU section 150 states in the third standard of field work that an auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.

13.128 AU section 326 defines *audit evidence* as all the information used by the auditor in arriving at the conclusions on which the audit opinion is based and includes the information contained in the accounting records underlying the financial statements and other information.

13.129 Paragraph .03 of AU section 339, *Audit Documentation* (AICPA, *Professional Standards*), states that the auditor must prepare audit documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached. Audit documentation

- a. provides the principal support for the auditor's report that the auditor performed the audit in accordance with GAAS,¹² and
- b. provides the principal support for the opinion expressed regarding the financial information or the assertion to the effect that an opinion cannot be expressed.

13.130 Paragraph .04 of AU section 339 states that audit documentation is an essential element of audit quality. Although documentation alone does not guarantee audit quality, the process of preparing sufficient and appropriate documentation contributes to the quality of an audit.¹³

13.131 Paragraphs .05–.06 of AU section 339 states that examples of audit documentation are audit programs, analyses, issues memoranda, summaries of significant findings or issues, letters of confirmation and representation, checklists, abstracts or copies of important documents, correspondence (including e-mail) concerning significant findings or issues, and schedules of work the auditor performed. Abstracts or copies of the entity's records (for example,

¹² 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.

¹³ 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 GAAS, 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. The elements of quality control are identified in QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*). See also AU section 161, *The Relationship of Generally Accepted Auditing Standards to Quality Control Standards* (AICPA, *Professional Standards*).

significant and specific contracts and agreements) should be included as part of the audit documentation if they are needed to enable an experienced auditor to understand the work performed and conclusions reached. Audit documentation may be recorded on paper or on electronic¹⁴ or other media.

Consideration for Audits Conducted in Accordance With PCAOB Standards

Auditing Standard No. 3, *Audit Documentation* (AICPA, *PCAOB Standards and Related Rules*, Auditing Standards), established general requirements for documentation the auditor should prepare and retain in connection with engagements conducted pursuant to the standards of the PCAOB. *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 also 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.

13.132 In addition to the requirements discussed previously, AU section 339 establishes further requirements about the content, ownership, and confidentiality of audit documentation. Moreover, appendix A, "Audit Documentation Requirements in Other Statements on Auditing Standards," to AU section 339 lists the audit documentation requirements contained in other areas of the *AICPA Professional Standards*.

13.133 Audit documentation is the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. Audit documentation, also known as working papers or workpapers, may be recorded on paper or on electronic or other media. When transferring or copying paper documentation to another media, the auditor should apply procedures to generate a copy that is faithful in form and content to the original paper document.

Auditor's Consideration of Using the Work of Internal Auditors

13.134 AU section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*), provides guidance on the auditor's consideration of the existence of an internal audit function in determining the nature, timing, and extent of auditing procedures to be performed and on using internal auditors to provide direct assistance to the auditor in an audit of financial statements performed in accordance with GAAS.

Considerations for Audits Performed in Accordance With PCAOB Standards

Paragraph .01 of AU section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA,

¹⁴ Interpretation No. 1, "Use of Electronic Confirmations," of AU section 330, *The Confirmation Process* (AICPA, *Professional Standards*, AU sec. 9330 par. .01–.08), states that secure and properly controlled electronic confirmations may be considered to be reliable audit evidence and discusses auditor considerations when using electronic confirmations.

PCAOB Standards and Related Rules, Interim Standards), states that when performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 16–19 of Auditing Standard No. 5 for discussion on using the work of others to alter the nature, timing, and extent of the work that otherwise would have been performed to test controls.

Using the Work of Other Specialists

13.135 AU section 336, *Using the Work of a Specialist* (AICPA, *Professional Standards*), provides guidance to the auditor who uses the work of a specialist in audits performed in accordance with GAAS. AU section 336 states that a specialist is a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing.

13.136 AU section 336 applies whenever the auditor uses a specialist's work as audit evidence in performing substantive procedures to evaluate material financial statement assertions, regardless of whether

- management engages or employs specialists;
- management engages a specialist employed by the auditor's firm to provide advisory services; or
- the auditor engages the specialist.

13.137 AU section 336 does not apply if a specialist employed by the auditor's firm participates in the audit. For example, if the auditor's firm employs appraisers as part of the audit team to evaluate the carrying value of properties, AU section 336 would not apply. In such cases, AU section 311 would apply.

13.138 AU section 336 states that the auditor should evaluate the professional qualifications of the specialist to determine whether he or she possesses the necessary skill or knowledge. AU section 336 states that the auditor should evaluate the specialist's experience and the type of work under consideration. For example, if the auditor is using an appraisal of commercial real estate values in connection with the audit of financial statements, he or she should evaluate the appraiser's professional qualifications and his or her experience with commercial real estate.

13.139 The auditor should obtain an understanding of the nature of the work performed or to be performed by the specialist. In a number of cases, the specialist's work may have been prepared for another purpose. In these situations, the auditor might consider the appropriateness of using the specialist's work to evaluate financial statement assertions. AU section 336 acknowledges that, in some cases, an auditor may need to contact the specialist to determine whether the specialist is aware that his or her work will be used for corroborating the assertions in the financial statements.

13.140 AU section 336 does not preclude the auditor from using a specialist who has a relationship with the client, including situations in which the client has the ability to directly or indirectly control or significantly influence the specialist. AU section 336 does state, however, that the auditor should evaluate the relationship, including circumstances that might impair the specialist's objectivity. If the auditor believes that the specialist's objectivity might be impaired, the auditor should perform additional procedures with respect to some or all of the specialist's assumptions, methods, or findings to determine

that the findings are not unreasonable or should engage another specialist for that purpose.

Evaluating Misstatements

13.141 Based on the results of substantive procedures, the auditor may identify misstatements in accounts or notes to the financial statements. Paragraph .42 of AU section 312 states that auditors must accumulate all known and likely misstatements identified during the audit, other than those that the auditor believes are trivial and communicate them to the appropriate level of management. AU section 312 further states that auditors must consider the effects, both individually and in the aggregate, of misstatements (known and likely) that are not corrected by the entity. For issuers, this consideration includes, among other things, the effect of misstatements related to prior periods.¹⁵

13.142 AU section 312 and AU section 326 establish standards and provide guidance on evaluating audit findings and audit evidence, respectively.

Client Representations

13.143 AU section 333 establishes a requirement that the auditor obtain written representations from management as a part of an audit of financial statements performed in accordance with GAAS and provides guidance concerning the representations to be obtained. Such representations are part of the audit evidence the auditor obtains but are not a substitute for the application of auditing procedures. The auditor obtains written representations from management to complement other auditing procedures.

13.144 Written representations from management should be obtained for all financial statements and periods covered by the auditor's report. The specific written representations to be obtained depend on the circumstances of the engagement and the nature and basis of the presentation of the financial statements. Paragraph .06 of AU section 333 lists matters ordinarily included in management's representation letter.

13.145 Management's representations may be limited to matters that are considered either individually or collectively material to the financial statements, provided management and the auditor have reached an understanding on materiality for this purpose. The representations should be made as of a date no earlier than the date of the auditor's report. Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause an auditor to disclaim an opinion or withdraw from the engagement.

13.146 AU section 333 states that written representations should be addressed to the auditor. Because the auditor is concerned with events that occurred through the date of his or her report that may require adjustment or disclosure, the representations should be made as of the date of the auditor's report. The letter should be signed by those members of management with overall responsibility for financial and operating matters who the auditor believes are responsible for and knowledgeable about, directly or through others

¹⁵ SEC Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment.

in the organization, the matters covered by the representations. Normally, this includes the chief executive officer and the chief financial officer, among others.

Considerations for Audits Performed in Accordance With PCAOB Standards

When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 75–77 of PCAOB Auditing Standard No. 5 for additional required written representations to be obtained from management.

Communication With Those Charged With Governance

13.147 AU section 380, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*), establishes standards and provides guidance on the auditor's communication with those charged with governance in relation to an audit of financial statements. Although this section applies regardless of an entity's governance structure or size, particular considerations apply when all of those charged with governance are involved in managing an entity. This section does not establish requirements regarding the auditor's communication with an entity's management or owners unless they are also charged with a governance role.

13.148 AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*), establishes standards and provides guidance on communicating matters related to an entity's internal control over financial reporting identified in an audit of financial statements. It is applicable whenever an auditor expresses or disclaims an opinion on financial statements. In particular, AU section 325

- defines the terms *deficiency in internal control*, *significant deficiency*, and *material weakness*;
- provides guidance on evaluating the severity of deficiencies in internal control identified in an audit of financial statements; and
- requires the auditor to communicate, in writing, to management and those charged with governance, significant deficiencies and material weaknesses identified in an audit.

13.149 Deficiencies identified during the audit that, upon evaluation, are considered significant deficiencies or material weaknesses under this section should be communicated, in writing, to management and those charged with governance as a part of each audit, including significant deficiencies and material weaknesses that were communicated to management and those charged with governance in previous audits and have not yet been remediated. Significant deficiencies and material weaknesses that previously were communicated and have not yet been remediated may be communicated, in writing, by referring to the previously issued written communication and the date of that communication. The written communication is best made by the report release date, which is the date the auditor grants the entity permission to use the auditor's report in connection with the financial statements, but should be made no later than 60 days following the report release date.

13.150 Nothing precludes the auditor from communicating to management and those charged with governance other matters related to an entity's internal control. For example, the auditor may communicate

- matters the auditor believes to be of potential benefit to the entity, such as recommendations for operational or administrative efficiency, or for improving controls.
- deficiencies that are not significant deficiencies or material weaknesses.

If other matters are communicated orally, the auditor should document the communication.

13.151 Exhibit B, "Examples of Circumstances That May Be Deficiencies, Significant Deficiencies, or Material Weaknesses," of AU section 325 includes examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses.

13.152 AU section 325 is not applicable if the auditor is engaged to examine the design and operating effectiveness of an entity's internal control over financial reporting that is integrated with an audit of the entity's financial statements under AT section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements* (AICPA, *Professional Standards*).

Considerations for Audits Performed in Accordance With PCAOB Standards

In an integrated audit of financial statements and internal control over financial reporting, paragraphs 78–84 of Auditing Standard No. 5 provides guidance regarding communication of certain matters to the audit committee. In evaluating whether a deficiency exists and whether deficiencies, either individually or in combination with other deficiencies, are material weaknesses, the auditor should follow the direction in paragraphs 62–70 of Auditing Standard No. 5.

Going Concern Considerations

13.153 AU section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*), establishes requirements and provides guidance to auditors in evaluating—as part of every financial statement audit—whether substantial doubt exists about the ability of the entity 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 auditor's evaluation of a gaming entity's ability to continue as a going concern may be one of the most complex and important portions of the audit. This section describes the unique issues that an auditor may encounter in evaluating a gaming entity's ability to continue as a going concern.

13.154 Gaming entities operate in a highly regulated environment. As a result, laws and regulations can have a significant effect on their operations. In accordance with paragraph .03 of AU section 341, the auditor should consider whether substantial doubt exists about a gaming entity's ability to continue as a going concern for a reasonable period of time in the following manner:

- a. The auditor considers whether the results of procedures performed in planning, gathering audit evidence relative to the various audit objectives, and completing the audit identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. It may be necessary to

obtain additional information about such conditions and events, as well as the appropriate audit evidence to support information that mitigates the auditor's doubt.

- b. If the previous considerations lead the auditor to believe that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should obtain information about management's plans intended to mitigate the adverse effects of the conditions or events that gave rise to the doubt and assess the likelihood that such plans can be effectively implemented.
- c. After evaluating management's plans, the auditor concludes whether he or she has substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. If the auditor concludes there is substantial doubt, he or she should (i) consider the adequacy of disclosure about the entity's possible inability to continue as a going concern for a reasonable period of time, and (ii) include an explanatory paragraph (following the opinion paragraph) in his or her audit report to reflect his conclusion. If the auditor concludes that substantial doubt does not exist, he or she should consider the need for disclosure.

13.155 AU section 341 states that it is not necessary to design audit procedures solely to identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the ability of an entity to continue as a going concern for a reasonable period of time. The results of auditing procedures designed and performed to achieve other audit objectives should be sufficient for that purpose. The following are examples of procedures normally performed in audits of the financial statements that may identify such conditions and events:

- a. Analytical procedures
- b. Review of subsequent events
- c. Review of compliance with the terms of debt and loan agreements
- d. Reading of minutes of meetings of the board of directors and important committees of the board
- e. Inquiry of an entity's legal counsel about litigation, claims, and assessments
- f. Confirmation with related and third parties of the details of arrangements to provide or maintain financial support
- g. Review of the financial strength and liquidity of the parent company, if applicable
- h. Review of reports of significant examinations and related communications between regulators and the gaming entity
- i. Review of compliance with regulatory requirements

13.156 In performing such audit procedures, the auditor may identify information about certain conditions or events that, when considered in the aggregate, indicate that there could be substantial doubt about the gaming entity's ability to continue as a going concern for a reasonable period of time. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with others.

The following are examples of such conditions and events that may be encountered in audits of gaming entities:

- a.* Recurring operating losses
- b.* Indications of strained liquidity
- c.* Concerns expressed or actions taken by regulatory authorities regarding alleged unsafe or unsound practices
- d.* Indications of strained relationships between management and regulatory authorities

13.157 Paragraph .10 of AU section 341 states that if, after considering management's plans, the auditor concludes that there is substantial doubt about the gaming entity's ability to continue as a going concern for a reasonable period of time, the auditor should consider the possible effects on the financial statements and the adequacy of the related disclosures. Some of the information that might be disclosed includes

- a.* pertinent conditions and events giving rise to the assessment of substantial doubt about the institution's ability to continue as a going concern for a reasonable period of time;
- b.* the possible effects of such conditions and events;
- c.* management's evaluation of the significance of those conditions and events and any mitigating factors;
- d.* possible regulatory sanctions, including the discontinuance of operations;
- e.* management's plans (including information about the gaming entity's capital plan and relevant prospective financial information); and
- f.* information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

13.158 Paragraph .12 of AU section 341 states, if, after considering identified conditions and events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph (following the opinion paragraph) to reflect that conclusion.

13.159 Paragraph .11 of AU section 341 states the auditor's consideration of disclosure should include the possible effects of such conditions and events, and any mitigating factors, including management's plans.

13.160 AU section 341 states that in connection with the guidance stated previously, the auditor should document all of the following:

- a.* The conditions or events that led him or her to believe that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time.
- b.* The elements of management's plans that the auditor considered to be particularly significant to overcoming the adverse effects of the conditions or events.
- c.* The auditing procedures performed and evidence obtained to evaluate the significant elements of management's plans.
- d.* The auditor's conclusion about whether substantial doubt about the entity's ability to continue as a going concern for a reasonable

period of time remains or has been alleviated. (If substantial doubt remains, the auditor also should document the possible effects of the conditions or events on the financial statements and the adequacy of the related disclosures. If substantial doubt is alleviated, the auditor also should document the conclusion regarding the need for disclosure of the principal conditions and events that initially caused him or her to believe there was substantial doubt.)

- e. The auditor's conclusion regarding whether he or she should include an explanatory paragraph in the audit report. (If disclosures with respect to an entity's ability to continue as a going concern are inadequate, the auditor also should document the conclusions regarding whether to express a qualified or adverse opinion for the resultant departure from GAAP.)

Supplemental Information

13.161 A gaming entity may publish various documents that contain information in addition to audited financial statements and the auditor's report thereon.[†] AU section 550, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*), provides guidance for the auditors and clarifies that an auditor may issue a report providing an opinion, in relation to the basic financial statements as a whole, on supplementary information and other information that has been subjected to the auditing procedures applied in the audit of those basic financial statements.

13.162 In some circumstances, an auditor submits to the client or others a document that contains information in addition to the client's basic financial statements and the auditor's report thereon. AU section 551,[†] *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*), provides guidance on the form and content of reporting when an auditor submits to his client or to others a document that contains information in addition to the client's basic financial statements and the auditor's report thereon.

13.163 AU section 558,[†] *Required Supplementary Information* (AICPA, *Professional Standards*), states that FASB, Governmental Accounting Standards Board (GASB), and the Federal Accounting Standards Advisory Board (FASAB) develop standards for financial reporting, including standards for financial statements and for certain other information supplementary to financial statements. This section provides the auditor with guidance on the

[†] In February 2010, the Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 118, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, AU sec. 550); SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*, AU sec. 551); and SAS No. 120, *Required Supplementary Information* (AICPA, *Professional Standards*, AU sec. 558). These SASs amend or supersede AU section 550A, *Other Information in Documents Containing Audited Financial Statements*; AU section 551A, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*; and AU section 558A, *Required Supplementary Information* (AICPA, *Professional Standards*), respectively. Collectively, these statements address the auditor's responsibilities with respect to information that is required by a designated standard setter (that is, FASB, the Governmental Accounting Standards Board, the Federal Accounting Standards Advisory Board, and the International Accounting Standards Board) to accompany an entity's basic financial statements and supplementary information that is presented outside the basic financial statements. The effective date of the SASs is for audits of financial statements for periods beginning on or after December 15, 2010, and early application is permitted.

nature of procedures to be applied to supplementary information required by FASB, GASB, or FASAB and describes the circumstances that would require the auditor to report such information.

13.164 Refer to appendix A, "Illustrative Financial Statements," for illustrative financial statements and independent auditor's reports.

Chapter 14

Special Auditing Considerations

14.01 This chapter discusses auditing procedures unique to gaming entities. Refer to chapter 13, "General Auditing Considerations," of this guide for a discussion of general auditing considerations.

Cash Balances and Revenue Cutoff

14.02 A gaming entity's cash may include the following components:

- General bank accounts and imprest accounts, such as payroll
- Special purpose bank accounts, such as field office accounts
- Cash and cash equivalents on hand, which may include cage accountability, drop boxes, gaming devices, automated teller machines (ATMs), redemption kiosks, and change booths

Components of Cage Accountability

14.03 Certain assets and liabilities included in cage accountability are normally recorded on the general ledger individually; many of these items are initially recorded in the cage accountability and later reclassified. The cage accountability normally comprises the following components:

- Currency and coins
- House chips, including reserve chips, and tokens
- Personal checks, cashier's checks, and traveler's checks for deposit
- *Customer deposits*,¹ often called "front money" (The related cash is usually commingled with the casino's cash, and the customer deposits balance is treated as a liability.)
- Chips of other casinos (Regulations may prohibit acceptance of such *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
- Imprest bank accounts
- Gaming and other device loads (including currency or coin, or both, loaded in slot machine hoppers, ATMs, and redemption kiosks)
- Fills, credits, and other items of value (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.)
- Markers

Some of the items previously listed 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).

¹ Terms that appear in the glossary are shown in *italics* the first time they appear.

14.04 For financial statement presentation, certain amounts are reclassified unless immaterial. Chips on hand are offset against chips in service; the net liability represents the outstanding chip liability. Markers are reclassified to accounts receivables. Customer deposits are reclassified to a current liability account.

Cage Procedures

14.05 Cage transactions 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 markers, cash or chips for markers, or customer deposit 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 participation of several individuals in the transactions, and they are evidenced by the participants' signatures on documents as well as by supervisory observation.

14.06 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 or withdrawals, and amounts paid out for promotional items.

Tests of Accountability

14.07 The most important aspects of testing the cage accountability are the 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 in connection with reconciliation to the general ledger. For details on the timing of these procedures see paragraphs 14.31–38.

14.08 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 any cash in the casino cage is not included in the cage accountability.

14.09 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.

14.10 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 and may consider performing test counts on individual bundles of bills. Coins and chips will normally be similarly tested.

14.11 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.

14.12 Customer deposit 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.

14.13 Markers, 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.

Cutoff Procedures

14.14 Most casino revenue 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 markers. 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.

14.15 Many casinos operate 24 hours a day. Because 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

14.16 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. The auditor may also wish to observe the removal of drop boxes until they are stored and locked in the count room.

14.17 A proper cutoff of marker 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 markers have not been issued, are determined as of the same time that the revenue is cutoff. 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.

Slot Machines

14.18 Unlike other games, slot machines are typically not dropped and counted each day. In larger gaming operations, a portion of the slot machines will be dropped and counted daily so that by the end of each week, all machines would have been dropped and counted at least once. If the count of coin-operated or currency and voucher-operated gaming devices is at a later date than the cutoff and a portion of this drop is to be included in revenue, the auditor may wish to observe the removal of drop buckets and *currency acceptor drop boxes*, the reading of machine meters, and the transfer of the drop buckets and currency acceptor drop boxes to the count room. The auditor 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

14.19 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 amounts 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. Because 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.

14.20 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.

14.21 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.

Drop and Count Procedures

14.22 The drop and count of proceeds for the final shift proceeding the cutoff time will normally be made during business hours of the following business day. Count procedures, some or 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 controls surrounding the key(s) to the locked area to the drop boxes are observed.
- 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 testing 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.

14.23 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, which may be a manually prepared or electronically generated document.

14.24 When the count team completes their work, members of the team sign the count sheets, the count proceeds are transferred to the casino cage, and the related documentation is transferred directly to the accounting department and not left in the custody of the cage department.

14.25 The count of gaming device proceeds is made in a similar manner, with proceeds from each machine recorded separately. Currency acceptor drop box contents are counted in a similar manner as previously described. Coins are normally counted by a coin machine or weighed. For this count, the auditor should also consider testing the count machines or weighing device's accuracy. Procedures should be in effect to ensure that any other funds present in the count room are segregated from gaming device proceeds.

Receivables

Background

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

14.27 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 consideration of the confirmation of receivables or reduce the auditor's responsibility for satisfying himself or herself concerning the existence and collectibility of receivables.

14.28 The auditor should understand the gaming entity's policies for granting credit and the regulatory requirements in the jurisdiction. Credit may be extended to customers, for example, in the pit or at the cage. Gaming receivables are usually represented by executed instruments acknowledging receipt of credit, which is usually extended in the form of gaming chips. The

markers include markers, or *counter checks*; postdated or currently dated *hold checks*; and returned checks.

14.29 The legal status of various types of gaming receivables may differ, depending on the jurisdiction. Markers issued in a U.S. gaming jurisdiction may not be legally enforceable in some foreign countries, but the U.S. assets of foreign customers may be reached to satisfy judgments entered in the United States.

Confirmation of Gaming Receivables

14.30 AU section 330, *The Confirmation Process* (AICPA, *Professional Standards*), and AU section 330, *The Confirmation Process* (AICPA, *PCAOB Standards and Related Rules*, Interim Standards), provide guidance regarding the confirmation process in audits performed in accordance with generally accepted auditing standards. Both AU sections presume that the auditor will request the confirmation of receivables unless certain conditions exist. One of those conditions is that the use of confirmations would be ineffective. For example, if based on prior years' audit experience or experience from similar audit engagements, an auditor may conclude that response rates to properly designed confirmation requests will be inadequate, or if responses are known or are expected to be unreliable, the auditor may determine that the use of confirmations would be ineffective. Because of the sensitivity around gaming markers, an auditor may conclude that the response rate to confirmations will be inadequate based upon the auditor's experience on that engagement or on similar engagements. If the auditor concludes that the use of the confirmations would be ineffective and elects not to send confirmations, the auditor should document that decision. Additionally, sufficient alternative procedures to substantiate the existence of accounts receivables would be performed, and such procedures might include the inspection of markers in the cage, verifying the date the markers were issued.

14.31 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 markers held in the pit is particularly difficult because 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.

14.32 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 a possibility exists 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 may not keep 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. Although casino customers' balances may include several separately executed instruments, it is possible that the customers will be able to confirm only their account balances. They may not know, or have records of, the individual components of their balances.

14.33 The audit procedures for gaming receivables will involve the use of 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. Customers may be more sensitive to contact about their accounts than customers in other businesses. 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 gaming 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. Because 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 gaming receivables.

14.34 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.

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

Mail Circularization

14.36 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. 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 or herself about the validity of the address and to reduce the number of confirmation requests returned by the postal service, he or she 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

14.37 Telephone contacts are normally limited to situations in which management or customers have indicated that no mail contact be made 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

14.38 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

14.39 The primary documentary evidence of a casino receivable is the executed markers. 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 in the form of chips or currency. To overcome this problem, the auditor may 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

14.40 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 markers from customers. Because the staff in such offices is usually small, little, if any, segregation of duties exists 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 markers located at the branches are subject to the tests described in this chapter. Accordingly, the auditor's visits to selected branch offices should be scheduled concurrently with the performance of tests of all markers 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. 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

14.41 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 markers.

14.42 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 aging when current markers 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 aging 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.

Special Considerations for New Gaming Operations

14.43 Gaming entities will occasionally open new operations in expanding markets or acquire existing gaming operations in efforts to grow and expand. During such transitions and openings, the auditor may need to consider the following:

- Balance of chips and tokens placed in service
- The ability to reconcile cage accountability and components of gaming revenue considering (a) unanticipated volumes upon opening, (b) new untested systems, and (c) a significant number of new employees unfamiliar with the industry, entity, or the systems and process of the operation
- Level of observation, supervision, and testing performed by client personnel to support opening balance sheet items
- Support obtained through observation, count sheets, and other evidence of gaming assets and liabilities assumed, such as progressives, chips and token liabilities, significant markers, race and sports futures and unpaids, slot hopper loads, loyalty program accruals, and revenue accruals

Unannounced Audit Procedures

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

14.45 Because the auditor's tests of controls attempt to determine whether the controls are actually in effect, the observation of gaming 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 cage

and count room should not be announced in advance even though security procedures will usually prevent them from being undisclosed.

14.46 In addition, these observations should be carried out at various times throughout the period under audit. Letters of introduction to gaming 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 15

Internal Control

Introduction

15.01 An important element of the gaming industry is the robust system of internal control developed by gaming operators and typically mandated by the respective gaming regulatory bodies in the jurisdictions where gaming has been legalized. The following discussion describes key elements of the internal control structure typically present in a gaming operation.

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

15.03 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.

15.04 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, electronic systems, and other mechanical devices used as part of internal control.

15.05 Locked security devices are used to accumulate and safeguard cash before the initial count of cash and the assumption of custody by the 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 gaming personnel carry out their assigned duties of supervision and observation, satisfactory control can be achieved over this aspect of operations.

15.06 Systems of people watching people, including the *eye in the sky*¹ and closed circuit television, are major components in gaming operation internal control. To support these visual control techniques, the handling and movement of cash and chips should be standardized.

15.07 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 environment, segregation of duties is of paramount importance in the overall control considerations.

15.08 Numerous data processing controls exist that include systems to monitor and record slot machine activity, table game activity, player tracking, and rewards programs.

¹ Terms that appear in the glossary are shown in *italics* the first time they appear.

Gaming Internal Control Considerations

15.09 Management is responsible for establishing and maintaining effective controls over gaming operations. The following items illustrate control objectives and techniques for certain functions unique to gaming that management may wish to consider in establishing specific controls concerning the ability to record, process, summarize, and report financial data that is consistent with management's assertions embodied in financial statements. These items are not intended to be all-inclusive and are provided as an overview of control objectives and the related controls for management to consider when establishing internal control over a gaming operation. Additionally, the auditor may wish to consider the following internal control objectives when assessing the adequacy of the gaming internal control environment, along with any internal control requirements established by the regulators of the jurisdiction in which the gaming operation is located that may be applicable to the financial statement audit.

Granting and Control of Credit

Approval of Credit Lines and Maintenance of Credit Files

15.10 Controls exist to ensure that establishment of customer credit is authorized in accordance with the system. Examples include the following:

- Adequate segregation of duties exists between the functions of approving credit lines, issuing 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 an identification credential from an applicant; record information, such as name, address, and applicant's signature; and verify applicant's credit worthiness.
- 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.

Issuance of Credit

15.11 Controls exist to ensure that procedures are maintained in accordance with management's policies, for example, a clear statement of procedures is in place (that is, procedural manuals, training routines, supervisory requirements, and so forth).

15.12 Only those credit requests that meet management's criteria are granted. Examples include the following:

- Formal procedures exist for determining a customer's identity and whether a customer has an approved credit line with available credit that is sufficient for credit issuance.

- Individuals who may process credit-request clearances are designated.
- Exception-reporting procedures are in place (for example, voided markers, over credit limit, unpaid old balances, and so forth).
- Procedures are adequate to safeguard the integrity of pit and casino cashier credit files.
- Appropriate supervision of credit issuance activities is provided, including supervisory approval of transactions.
- Credit issuances at table games are evidenced by *lammer buttons* or markers placed by supervisory personnel on the table in public view.
- Markers are prenumbered or concurrently numbered by computerized system, and there is subsequent accountability for them.
- Voided markers are properly authorized and documented by the department that issued the credit instrument.
- Unissued marker forms are adequately safeguarded.
- Adequate segregation of duties exists between the functions of approving credit lines and issuing markers.
- Customers acknowledge credit by signing the markers.
- Timely preparation of receivable records for subsequent accountability.
- Adequate interim procedures exist to control credit extension when play occurs prior to formal documentation of a marker (that is, rim play).

Recording of Credit Transactions

15.13 Each marker issuance and payment transaction is promptly and accurately recorded in appropriate credit records (via document or electronic file, or both).

Custody of Markers

15.14 To adequately safeguard markers, periodic reconciliations are completed, in detail and in total, of the actual markers to the records. Additionally, a reconciliation should periodically be performed by someone independent of the custodial function. Adequate segregation of duties exists between employees responsible for custody of markers and those responsible for credit authorization and collection.

15.15 *Writeoffs and settlements*

- Written-off or settled markers are authorized in writing by management officials, at least one of whom is independent of the initial credit limit approval and the issuance and collection of credit relative to the patron's account.
- Adequate segregation of duties exists for approving credit lines, issuing credit, and collecting credit when writing off or settling markers.
- At least two management officials indicate in writing their authorization of the writeoff or settlement of a marker. Additional

officials may be required to authorize more material writeoffs and settlements.

- For prearranged settlements or discounts of markers, documentation is prepared evidencing the terms of the agreement before the commencement of credit play.

Bingo

15.16 *Bingo card sales*

- Bingo cards (electronic and paper) are sold consecutively through the assigning of a transaction number.
- When an electronic bingo card is sold, a unique number of the bingo card sold to the patron for play during the upcoming bingo session is immediately recorded in an unalterable manner.
- When a computerized bingo system is used, the system is used to record the card sale (electronic and paper) on a restricted transaction log or computer storage media.
- Voiding bingo card sales are documented as follows:
 - For a computerized bingo system, the void information is recorded in the computer, and the computer documents the appropriate information pertaining to the voided card sale. A supervisor authorizes the voiding of the card sale through the system.
 - For not-in-computer voids, the bingo card is marked "void" and signed by a supervisor authorizing the voiding of the card sale.
 - Procedures are established to prohibit the voiding of card sales (electronic and paper) after the start of the calling of the game for which the bingo card was sold.
- Bingo card sales (electronic and paper) are documented on a summary report, which includes the date and time, session, beginning and ending assigned transaction numbers of cards sold (by type), number of cards sold (by type), dollar amount of cards sold (by type), and total dollar amount of cards sold.
- An individual independent of the bingo card seller verifies the accuracy of the information on the summary report by reconciling the dollar amount of cards sold to the number of cards sold.

15.17 *Bingo number selection*

- Establish procedures to ensure the correct calling of numbers selected in the bingo game.
- Each ball is shown to a television camera immediately after it is called so that it is individually displayed to all patrons.
- Establish procedures to ensure that the numbered balls are placed back into the selection device prior to calling the next game.
- Number selection by a random number generator requires an automatic recording of the numbers selected from the random number generator into the computerized bingo system. Bingo personnel should be prevented from changing the numbers selected.

- Bingo personnel are precluded access to the random number generator.

15.18 *Bingo payouts*

- The authenticity of each payout (including the payout amount and type of winning card) is verified by at least two persons.
- The winning bingo card is verified to ensure that the winning bingo card was sold for the session and the game during which it was played and was not voided.

15.19 *Bingo funds.* Bingo funds are counted by at least two individuals and reconciled to the recorded amounts.

Cage

15.20 *Customer deposits*

- Customer deposits and withdrawals for safekeeping or *front money* purposes are accurately recorded.
- Customer receipts are two-part documents, sequentially numbered, and contain the customer's name, date, dollar amount of transaction, and nature of deposit (for example, cash, personal check, chips)
- Customer deposit balances are reconciled to deposits and withdrawals at least daily.

15.21 *Accountability*

- Cage assets are counted by two persons, reconciled for each shift, and are summarized on an accountability form.
- Increases and decreases in cage inventory are supported by documentation.

Card Games

15.22 *Card room funds*

- Transfers between table banks and the main card room bank are authorized by supervisory personnel and evidenced by the use of lammer buttons.
- Transfers from the main card room bank to the table banks are verified by the card room dealer and the runner.
- Transfers between the main card room bank and the casino cage are properly authorized by individuals designated by management and documented.
- The main card room bank is counted and reconciled on at least a per-shift basis.
- The table banks are counted and reconciled by a dealer and a supervisor on at least a per-shift basis.

15.23 *Drop and count.* The procedures for the drop and count of card room drop boxes are the same as those for table games.

15.24 *Shills.* Issuance of shill funds are authorized by supervisory personnel. Shill funds returns are recorded and verified, and replenishment of shill funds is documented.

Gaming Tournaments

15.25 *Control examples for gaming tournaments*

- Tournament entry fees and prize payouts are recorded as transacted and are summarized on an accountability document on a daily basis.
- Tournament rules are retained and are available to patrons for review. Such rules include the conditions that must be met by patrons to advance through the tournament, dollar amount of prize pool, and distribution of prizes based on specific outcomes.
- Results of tournaments are recorded denoting name and date of event, total number of entries, dollar amount of entry fees, total prize pool, and dollar amount paid for each winning category.

Information Technology

15.26 *System controls*

- The main computers for each gaming application are in a secured area with restricted access to individuals authorized by management.
- The computer system, including application software, is secured through the use of passwords, biometrics, or other means.
- Procedures are established for backup of data files and recovery of the system.

15.27 *User controls*

- Unique passwords are assigned to each individual using the system unless user access is restricted to inquiry-only functions.
- System passwords are changed at least quarterly.
- Terminated employees do not have access to the system.

15.28 *Software changes*

- New program and program changes are documented, reviewed, and approved by IT supervisory personnel.
- Testing of new and modified programs is performed and documented prior to implementation.

15.29 *Remote access*

- Procedures are established to only allow authorized personnel to remotely access the system.
- Remote access to the system is immediately documented.
- The physical connection is disabled when the remote access is not in use.

Keno

15.30 *Keno wagering*

- A keno ticket includes the casino name, city, state, date, game number, ticket sequence number, station number, and wager information.
- For manual keno tickets, a legible restricted copy of written keno tickets is created. The computerized keno ticket information is concurrently recorded on a restricted transaction log or computer storage media that is not accessible to keno personnel.
- Voiding of computer tickets is recorded in the computer, and the computer documents the appropriate information pertaining to the voided wager. For not-in-computer voids, the void designation, date, and time is written or stamped on the original ticket. Two individuals (a supervisor and the writer of the ticket) must sign the ticket at the time of voiding.
- A supervisor, acting as a writer, may not authorize a void for a ticket he or she wrote that is in excess of a material dollar amount set by management. A supervisor, who is independent of the ticket written, authorizes the void by signing the ticket at the time of voiding.
- A keno ticket is not written or voided after a game has been closed and after the number selection process for the game has begun.

15.31 *Number selection*

- The number selection process is monitored and filmed by camera both prior to and subsequent to the calling of a game and should include empty rabbit ears, date and time, game number, and full rabbit ears.
- The selected numbers are recorded in the computer, which documents the date, game number, the time the game was closed, and the numbers drawn.
- For manual keno games, a *draw ticket* is produced indicating the numbers drawn, the race number, and date. The draw ticket is verified to the ball drawn by a second keno employee.
- Keno balls are inspected by two individuals prior to being placed into play to ensure all numbers are accounted for and that each ball has an equal chance of being selected during the calling of the game.
- More than one individual is required to access keno balls in play.
- Back-up keno ball inventories are secured to prevent access by one individual.
- Number selection by a random number generator requires an automatic recording of the numbers selected from the random number generator into the computerized keno system. Keno personnel are prevented from changing the numbers selected.
- Keno personnel are precluded access to the random number generator.

15.32 *Winning ticket verification and payment*

- The computerized ticket number is entered in the system to determine the amount to pay to the patron.
- The manual ticket is compared to the draw ticket by the writer to determine the amount of payout before being paid.
- All payouts are supported by documentation indicating payment of a keno ticket.
- Payment is precluded on tickets previously paid, unclaimed winning tickets after a period of time specified by management, voided tickets, and tickets not yet issued.
- Supervisor approval is required for payment on tickets that are not authorized through the computerized keno system.

15.33 *Keno funds*

- The computerized keno system indicates the amount of net cash that should be in the writer or cashier bank at the end of a shift. A supervisor is required to access this information.
- A cash summary report is prepared by a writer or cashier indicating the amount of cash turn in, the amount of net cash indicated by the computerized keno system, and variance between these two amounts.

Lotteries

15.34 *Number selection*

- Multiple ball-drawing devices and several inventories of balls are maintained, from which one device and one set of balls are randomly selected for a drawing.
- Ball inventories are secured when not in use to include dual-person key control, prenumbered seal, surveillance recording, and alarm.
- Predrawing and postdrawing tests are performed to ensure randomness, including weighing of each ball to confirm the weight is within acceptable tolerances.
- Tests of ball-drawing devices and balls are performed by lottery officials and an independent accountant and may be recorded via surveillance cameras.
- Several lottery officials and an independent accountant are present during the live ball drawings and may be televised so the public can view the number selection process.
- Ball draws will be recorded, and ball draw distributions will be analyzed over numerous ball draws to ensure randomness.
- Automated draw machines for smaller award drawings are secured in a similar manner.

15.35 *Network and database security*

- Controls are in place to prevent the addition of a winning ticket to the database after the system has been locked out to further ticket sales.

- Controls are in place to prevent unauthorized modification attempts to delete losing tickets, change the numbers of tickets already written so that a loser becomes a winner, or to increase the payment amount on a ticket to a higher amount than warranted.

15.36 *Other lottery controls*

- Cash reconciliations are performed and documented daily for the settlement process between the ticket agents and the central lottery office, including the electronic funds transfers between the agents and lottery office.
- Instant game tickets are adequately controlled from the time of generation by the printing company, until such time as a winning ticket is claimed and validated.
- Controls are in place to prevent the counterfeiting of instant game tickets and paying on a ticket multiple times.
- Video lottery terminal machines and networks are controlled in a similar fashion as slot machines are controlled in a casino environment.

Promotions and Incentive Programs

15.37 Some promotional and incentive program controls include the following:

- Promotional payouts made by an employee are documented to support the reduction in bank accountability.
- Material promotional payouts (dollar amounts determined by management) are supported by a document indicating date, time, dollar amount of payout (or description of merchandise), and signature of at least one employee completing the payout.

Race and Sports Book (for Computerized Systems)

15.38 *Equipment*

- The race and sports book periodically contacts an independent source to verify the correct time to use in the computerized race and sports system.
- A supervisor independent of the ticket writing and cashiering functions tests the time indicated by the computer.
- Date, time, and numerical sequence stamping machines, if used, are
 - directly and permanently wired to the electrical supply system or have a back-up power source to ensure an accurate time in the event of power loss to the machines.
 - accessed with keys that are maintained and used by a department or personnel who are independent of the ticket writing and cashiering function.
 - tested by an individual independent of the ticket writing function to ensure date and time accuracy to the nearest minute.

- For race tracks, totalizator systems are controlled to prevent unauthorized access.

15.39 *Race and sports wagering*

- A computerized customer ticket is issued and given to the patron. For wagers placed through communications technology (for example, telephone), a ticket is not issued. Instead, all wagering communications are to be electronically recorded (separate from the computerized race and sports system), and the recording is to be retained for a period of time specified by management.
- The ticket information is concurrently recorded on a restricted transaction log or computer storage media that is not accessible to race and sports book personnel.
- A wager is not voided after the outcome of an event is known.
- Voiding a race and sports wager is recorded in the computerized race and sports system:
 - The original ticket is marked with a void designation.
 - For not-in-computer voids, the date and time at which the ticket was voided is stamped on the original ticket.
 - All voided tickets are signed by the writer or cashier and the supervisor at the time of the void.
- Procedures exist to not accept any wager after the start of the event or after the occurrence of post time of an event for a race wager.
- The system provides wagering controls:
 - The cut-off time for event wagering is established in the system.
 - The system either is incapable of accepting a wager subsequent to the event cut-off time or produces a report that specifically identifies such wagers.
 - The system either is incapable of voiding a ticket subsequent to the cut-off time or produces a report that specifically identifies such voided tickets.
 - The system is incapable of establishing or changing cut-off or starting time to a time that is earlier than the current time of day.

15.40 *Race and sports payouts*

- Event results are entered into the system for computerized grading of all wagers prior to patrons receiving payouts on winning tickets.
- The computerized ticket number is entered in the system, or the ticket is scanned, to determine the amount to pay to the patron.
- For account wagers, the computer system automatically updates the patron's account when the event results are posted.
- All payouts are supported by documentation indicating payment of a ticket. The ticket is denoted with a paid designation along with the amount of payment and date.

- The computerized system is incapable of authorizing payment on a ticket that has been previously paid, on voided tickets, on losing tickets, and tickets not yet issued.
- Payouts made without computer authorization are reviewed by authorized management or supervisory personnel and evidenced by signature.

15.41 *Race and sports funds*

- The computerized race and sports system indicates the amount of net cash that should be in the writer or cashier bank at the end of a shift. A supervisor is required to access this information.
- A cash summary report is prepared by a writer or cashier indicating the amount of cash turn in, the amount of net cash indicated by the computerized race and sports system, and variance between these two amounts.

15.42 *Employee segregation of duties*

- The end-of-day reports are generated by or observed by a person from an independent department.
- Employees performing supervisory functions of approving void tickets and over-the-limit wagers do not write tickets unless
 - supervisory functions are limited to approving voids and over-the-limit wagers.
 - a supervisor, acting as a writer, may not authorize a void for a ticket that he or she wrote.
 - all tickets written by a supervisor are subsequently voided, and all not-in-computer voids are reviewed by accounting or audit personnel, or both, for any improprieties.
 - a supervisor, acting as a writer, may not authorize an over-the-limit wager for a ticket he or she writes.
- Employees who have access to an administrative terminal or perform administrative functions do not write or cash tickets.

Slot Machines

15.43 *Fills and payouts*

- Only those requests for transfers of cash or tokens to the slot machine hopper or fill cabinet and payouts to patrons that meet management's criteria are approved.
- Transfers of cash or tokens to the slot machine hopper or fill cabinet and payouts to patrons should be accurately and promptly recorded.
- Prenumbered or concurrently numbered by computerized system slips are used for transfers:
 - Manual slips are used in numerical sequence and accounted for by the accounting department; missing numbers are investigated.

- The slips indicate the machine number, date, time, dollar amount of fill or payout, reason for payout, and signatures of at least two employees.
 - When a sequentially-numbered *fill* and payout slip is voided, the employee completing the void marks "void" across the face of the form and signs adjacent to the void indication.
 - The cash or tokens are transferred only when accompanied by a slip.
- Payment on wagering instruments is verified for validity through the *cashless wagering system* prior to making payment.
 - Unredeemed wagering instruments are voided in the system by personnel independent of the slot department. The employee completing the void marks "void" across the face of the form and signs adjacent to the void indication.
 - 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 personnel authorized by management.
 - Slot fills are placed in the slot machines by personnel authorized by management.
 - Slot fills and payouts to patrons are witnessed by two employees as designated by management.
 - Access to important forms and processing areas should be permitted only in accordance with management's criteria:
 - Manual unissued and issued fill and payout slips are safeguarded, and adequate procedures are employed in the distribution, use, and control of same.

15.44 *Slot department funds*

- Funds are counted and reconciled at each shift change by incoming and outgoing custodians.
- Authorized transfers of cash or tokens to and from the slot department should be accurately and promptly recorded.
- Access to the slot department funds is restricted.
- Kiosks used for patron ticket redemption or for employees to obtain funds for jackpot payouts are counted and reconciled at least weekly.

15.45 *Count procedures (applies to both scheduled and unscheduled counts)*

- Physical safeguards present:
 - Surveillance monitoring of the drop and count processes.
 - Someone independent of the slot department is required to observe each time coin buckets and currency acceptor boxes are removed from the slot machine.

- Drop boxes and count rooms are controlled and restricted to appropriate personnel.
- Drop funds are collected and counted on a regular basis:
 - Scales and currency counters are tested regularly.
 - The count is performed by count teams consisting of employees with no incompatible functions.
 - If *weigh* and *wrap counts* for coin are made, they are compared, and differences are reconciled.
 - Coin and currency transfers of count proceeds out of the count room during the count are authorized by individuals designated by management and are documented on transfer forms.
 - At the end of the count, the currency amount recorded on the count sheet is reconciled to the amount of currency in the count room, including any currency transfers, by a count member who does not function as the sole recorder.
 - Count teams are adequately supervised.
 - Other funds present at the time of the count are adequately segregated.
- Counts are recorded promptly and accurately:
 - Counts of coin, currency, and wagering instruments are recorded on count sheets.
 - Wagering instruments removed from the drop box are recorded in the cashless wagering system.
 - Members of the count team sign the count sheets.
 - Count sheets are posted to the slot win sheet by the accounting department.
 - Any available meter readings of the slot machine are used to verify the accuracy of the recorded count, fill, payout, and win amounts. Any unreasonable differences are investigated.
 - Coins and currency are transferred to the casino cage immediately following the count, and they are agreed to the recorded count.

15.46 *Computerized player tracking, promotional accounts, promotion, and bonusing systems*

- Systems are restricted to access authorized by management personnel.
- The addition and deletion of points to player tracking accounts and the addition and deletion of cashable credits and noncashable credits to promotional accounts other than through actual slot machine play is documented and authorized or performed by supervisory personnel designated by management.
- Patron identification is required for account redemptions.

- Access to inactive and closed accounts is restricted to authorized supervisory personnel.

15.47 *Wide area progressive slot machines*

- The main computer for the wide area progressive system is in a secured area with restricted access to individuals authorized by management.
- The wide area progressive system, including application software, is secured through the use of passwords, biometrics, or other means.
- Procedures are established to verify the authenticity of the payout to the patron.
- Procedures are established to verify the accuracy of the *progressive meter* amount based on wagers made at participating casinos.
- Procedures are established to verify that each participating casino receives a proper pro rata allocation of the wide area progressive jackpot payout.

15.48 *Server based gaming systems*

- The database of control programs on the game server is controlled to prevent unauthorized access or modification.
- Records are created and maintained of game control programs added to, and deleted from, the game server.

Table Games

15.49 *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.
- Inadequately documented cross-fills, and even money exchanges in the pit, are prohibited.
- Prenumbered or concurrently numbered by computerized system slips are used for fills or credits:
 - Manual slips are used in numerical sequence and accounted for by the accounting department; missing numbers are investigated.
 - The slips indicate the table number, the denomination, shift, date, time, and amount.
 - All voided slips are clearly marked "void" across the face of the original and first copy of the slip and are signed by the cashier and one other individual adjacent to the void indication.
 - Chips, tokens, or monetary equivalents are transferred only when accompanied by a slip.

- 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.
- Fill and credit slips are inserted in the table game drop box by the dealer.
- 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:
 - Manual unissued and issued fill and credit slips are safeguarded, and adequate procedures are employed in the distribution, use, and control of same.

15.50 *Table inventories*

- Gaming chips are removed from the table inventory only
 - in exchange for credit slips from the casino cage.
 - in exchange for cash, markers, or chips from customers.
 - in payment of winning wagers.
- Inventories for tables not in use are under adequate physical control.
- For tables not in use, chips are counted and stored in locked containers attached to the gaming table or stored in another secure area.

15.51 *Count procedures (applies to both scheduled and unscheduled drops and counts)*

- Physical safeguards present:
 - Surveillance monitoring of the drop and count processes.
 - Someone independent of the pit department is required to observe each time table game drop boxes are removed from or placed in storage racks.
 - Procedures are established to ensure that unauthorized access to empty table game drop boxes does not occur from the time the boxes leave the storage racks until they are placed on the tables.
 - Drop boxes and count rooms are controlled and restricted to appropriate personnel.

- The contents of drop boxes are counted at least daily:
 - Currency counters are tested regularly.
 - 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 directly to the accounting department to ensure cage personnel do not have access to count documentation.
 - Currency transfers of count proceeds out of the count room during the count are authorized by individuals designated by management and are documented on transfer forms.
 - At the end of the count, the currency amount recorded on the count sheet is reconciled to the amount of currency in the count room, including any currency transfers, by a count member who does not function as the sole recorder.
 - 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.

15.52 *Rim play*

- Procedures are established to control rim play activity until such time as a marker is eventually issued.
 - Lammer buttons are placed in a neutral zone on the table to evidence the dollar amount of chips issued on rim play.
 - The patron's rim chip issuance and payment transactions and the outstanding rim balance are recorded on the patron's *rim card*.
 - *Rim credit* activity and the transactions recorded on the patron's rim card are monitored by a supervisor.
-

Chapter 16

Analytical Procedures

Introduction

16.01 Analytical procedures are an important part in the understanding of an entity's business. Key factors that influence an entity's business may be expected to affect that entity's financial and nonfinancial information. A basic premise underlying the application of analytical procedures is that relationships among data may reasonably be expected to exist and continue in the absence of known conditions to the contrary. Although some factors in this section highlight the casino's use of analytical procedures, its application has broader benefits and utilization.

Types of Analytical Procedures

16.02 The following are some examples of analytical procedures an entity's management may use in monitoring their business:

- Comparing current financial information to prior periods, anticipating results, and explaining variances
- Comparing current financial information to budgets or forecasts, including interim or annual data
- Comparing internal financial information to that of other entities, competitors, industry trends, or other available statistical data
- Understanding the relationship of financial information with relevant nonfinancial information

16.03 The following are some analytical procedures an auditor may perform:

- When auditing revenue with the objective of identifying unusual or unexpected relationships involving revenue accounts that may indicate a material misstatement due to fraudulent financial reporting, an auditor may perform analytical procedures because there is a lack of customer documentation regarding gross gaming revenue, and due to the resulting inability to apply tests of details, analytical procedures are especially important in testing gross gaming revenue.
- Some unusual or unexpected relations may arise during the performing of analytical procedures relating to unusual losses and unusual hold percentages (commonly referred to as *underholding* and *overholding variances*).
- A material misstatement due to fraudulent financial reporting.

16.04 Some sample factors for management or auditors, or both, to consider when applying analytical procedures include the following:

- Table games (by type)
 - Hold percentages by type of games: Each type of game will have similar hold percentage based on the rules of

the games (for example, hitting or not hitting on soft 17 changes the expected hold percentage).

- *Win*¹ per table.
- *Drop*² per table.
- Comparison to statistical probability curves (regression analysis).
- Slot machines (by denomination)
 - Actual hold percentage to theoretical hold percentage comparison (by game)
 - Comparison of theoretical win to actual win
 - Comparison of actual win to slot machine metered win, which may be an electronic meter
 - Average win per unit (machine)
 - Coin in per machine
 - Comparison of weighted average theoretical hold percentage for entire slot floor to actual hold percentage for all slot machines
- Keno, Bingo, and Race and Sports
 - Win-to-write percent
 - Write comparison to same month last year
 - For sports books, win-to-write percent broken out by type of sporting event
 - For pari-mutuel race books, comparison of win-to-write percentage to race track commission rate percentage
- Poker
 - Win comparison to the same month last year
 - Win comparison to the previous month
- Relationships with other departments (not limited to the following), if applicable:
 - Hotel
 - Food and beverage
 - Retail
 - Conventions
 - Entertainment
- Relationships with outside conditions
 - Traffic flow
 - Weather

¹ See the "Overview of Transactions in the Casino and the Casino Cage" section in chapter 3 for a detailed example of the calculation of win.

² Terms that appear in the glossary are shown in *italics* the first time they appear.

- Special events
- Local economic conditions

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

- Overall factors for all games
 - Economic conditions
 - Variations from industry statistics
 - Types of clientele
 - Size of operations
 - Wager limits
 - Seasonality of operations
 - Lack of sufficient volume
 - Promotional programs including free play wagering (may affect the hold percentage)
 - Turnover of personnel
 - Changes in competition
 - Change in clientele
 - Change in regulatory guidelines

Absent the preceding items, the following may need to be considered to have occurred:

- Errors in computation of various elements of hold percentage formulas (for example, drop incorrectly computed)
- Employee defalcation or patron theft

16.06 The following items may have an effect on hold percentages:

- Table games
 - Changes in rules of the games
 - Use of more decks or dealing devices
 - Change in volume of credit play
 - Large progressive pool payouts
 - Large wins or losses attributable to certain patrons
- Slot machines
 - Large jackpots
 - Reliability of meters and readings taken (for example, unusually low coin-in in relation to drop and win)
 - Improper matching of drop with jackpots (for example, timing differences)
 - Changes in machines or theoretical percentages, including game changes via server-based gaming systems
 - Mechanical failures

- Online slot systems (for example, proper interface with slots, file maintenance procedures)
- Keno and bingo
 - Changes in *payout schedule*
 - Large payouts
 - Problems with ball drawing device or random number generator affecting the distribution of numbers selected over a period of time
- Race and sports book
 - Layoff of bets
 - Adjustments of *point spread*
 - Limits on odds

Table Games and Poker

16.07 Meaningful comparison of win-to-drop percentages for table games among gaming entities can be difficult because, among other factors, some casinos include only net marker play (markers issued less payment received at the tables), rather than total markers issued, in computing drop. Win-to-drop percentages do not reflect the percentages of the total table game wagers won by the gaming entity 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 a drop, but decide not to play.

16.08 The extent of marker play and how it is recorded will also affect the comparability of ratios among gaming entities. If the players are permitted to pay off or make a partial payment on the markers at the tables and only the resultant net marker 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 markers at the tables. Similarly, rim credit allows credit issuances and payments to be tracked during a customer's play, netted, and amounts owing settled through the issuance of a marker. This also results in the understatement of drop and the overstatement of win-to-drop percentages.

16.09 Other factors that affect comparability of win-to-drop percentages are the type and experience of customers, the differences in rules of the games, and the betting limits that are in effect. Additionally, the use of promotional items may also affect hold percentages and may require the restatement of percentages as if the promotional items were, in fact, cash play.

16.10 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 gaming entity. Variations from an expected range should be investigated. To facilitate prompt investigation, there should be regular communication between the auditor and gaming entity's management during the year.

16.11 Some regulatory bodies may require the performance of these and other analytical review procedures on a periodic basis, along with the subsequent documentation of all findings. A review of such client-prepared documentation may aid in the auditor's performance of analytical review procedures.

Appendix A

Illustrative Financial Statements

This appendix provides illustrative financial statements of a nongovernmental hotel-casino and a governmental hotel-casino. These illustrative financial statements are not intended to establish requirements for reporting. In addition, the amounts shown are not intended to indicate any customary relationship among accounts. Other gaming entities should utilize these illustrative financial statements for the areas relevant in their circumstances.

The notes to the financial statements indicate the unique or significant, or both, subject matter often associated with casinos and generally disclosed by casinos, but such disclosures should be modified to suit individual circumstances as well as materiality considerations. These illustrative financial statements do not include all disclosures and presentation items promulgated, nor do they represent minimum standards or requirements. Preparers and auditors of Securities and Exchange Commission-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, including any disclosures discussed throughout other chapters in this guide, which may not be illustrated here. Such disclosures might include, among other items, information concerning related party transactions, subsequent events, pension plans, postretirement benefits other than pensions, postemployment benefits, income taxes, share-based payment transactions, lease commitments, extraordinary items, accounting changes, off-balance sheet risks, concentrations of credit risk, derivatives, the fair value of financial instruments, and other matters that are not unique to casinos.

Nongovernmental Gaming Entity

Illustrative financial statements and footnotes of a *nongovernmental gaming entity* directly follow the Independent Auditor's Report.

Independent Auditor's Report

To the Board of Directors and Stockholders of
ABC Casinos, Inc.
Anywhere, Any State

We have audited the accompanying balance sheets of ABC Casinos, Inc. (ABC) as of December 31, 2011 and 2010, and the related statements of income and retained earnings, and of cash flows for the years then ended. These financial statements are the responsibility of ABC'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. 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 ABC's internal control over financial reporting. Accordingly, we express no such opinion. 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.

In our opinion, such financial statements present fairly, in all material respects, the financial position of ABC Casinos, Inc. as of December 31, 2011 and 2010, 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.

John Doe and Associates, CPAs

Anywhere, Any State

March 15, 2012

ABC Casinos, Inc.
Balance Sheets

	<i>December 31,</i>	
	<i>2011</i>	<i>2010</i>
<i>Assets</i>		
Current assets		
Cash and cash equivalents	\$5,678,300	\$3,787,100
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	7,719,100	5,711,400
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)	(7,100,985)
Net property and equipment	30,383,900	31,697,615
Other assets and deferred charges, net	1,300,000	1,200,000
Total assets	\$39,403,000	\$38,609,015

	<i>December 31,</i>	
	<u>2011</u>	<u>2010</u>
<i>Liabilities and Stockholders' Equity</i>		
<hr/>		
Current liabilities		
Current portion of long-term debt	\$1,000,000	\$700,000
Accounts payable	928,600	839,200
Deferred income taxes	450,075	375,000
Income taxes payable	150,000	161,000
Other	<u>344,400</u>	<u>207,600</u>
Total current liabilities	2,873,075	2,282,800
Long-term debt, less current portion	15,800,000	16,800,000
Deferred income taxes	<u>618,125</u>	<u>501,000</u>
Total liabilities	<u>19,291,200</u>	<u>19,583,800</u>
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	<u>12,616,000</u>	<u>11,529,415</u>
Total stockholders' equity	<u>20,111,800</u>	<u>19,025,215</u>
Total liabilities and stockholders' equity	<u>\$39,403,000</u>	<u>\$38,609,015</u>

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

ABC Casinos, Inc.
Statements of Income and Retained Earnings

	<i>Year Ended December 31,</i>	
	<u>2011</u>	<u>2010</u>
Revenue		
Gaming	\$13,802,300	\$12,532,100
Rooms	3,100,600	2,827,200
Food and beverage	2,100,300	1,740,200
Other	<u>1,000,000</u>	<u>900,000</u>
	20,003,200	17,999,500
Less: Promotional allowances	<u>(2,109,400)</u>	<u>(1,858,400)</u>
Net Revenues	<u>17,893,800</u>	<u>16,141,100</u>
Costs and expenses		
Gaming	4,012,100	3,717,600
Rooms	1,800,000	1,600,000
Food and beverage	1,500,000	1,200,000
Other	400,000	300,000
Selling, general, and administrative	3,021,900	2,707,700
Depreciation and amortization	<u>2,602,715</u>	<u>2,597,431</u>
Total operating costs and expenses	<u>13,336,715</u>	<u>12,122,731</u>
Operating income	4,557,085	4,018,369
Interest expense	<u>(2,050,300)</u>	<u>(1,935,300)</u>
Income before income taxes	2,506,785	2,083,069
Less provision for income taxes	<u>(970,200)</u>	<u>(818,000)</u>
Net income	1,536,585	1,265,069
Retained earnings, January 1	11,529,415	10,714,346
Dividends (\$.45 per share in each year)	<u>(450,000)</u>	<u>(450,000)</u>
Retained earnings, December 31	<u>\$12,616,000</u>	<u>\$11,529,415</u>

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

ABC Casinos, Inc.
Statements of Cash Flows

	<i>Years Ended</i> <i>December 31,</i>	
	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Net income	\$1,536,585	\$1,265,069
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,602,715	2,597,431
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 payable	(11,000)	(18,300)
Other liabilities	136,800	74,200
Net cash provided by operating activities	<u>4,330,200</u>	<u>4,075,500</u>
Cash flows from investing activities:		
Proceeds from sale of furniture and equipment	106,200	437,300
Payments for purchases of furniture and equipment	<u>(1,395,200)</u>	<u>(435,200)</u>
Net cash provided by (used in) investing activities	<u>(1,289,000)</u>	<u>2,100</u>
Cash flows from financing activities:		
Repayment of long-term debt	(700,000)	(1,000,000)
Dividends	<u>(450,000)</u>	<u>(450,000)</u>
Net cash used in financing activities	<u>(1,150,000)</u>	<u>(1,450,000)</u>
Net increase in cash and cash equivalents	1,891,200	2,627,600
Cash and cash equivalents at beginning of year	<u>3,787,100</u>	<u>1,159,500</u>
Cash and cash equivalents at end of year	<u>\$5,678,300</u>	<u>\$3,787,100</u>
Supplemental disclosure of cash flow data:		
Cash paid during the years for:		
Interest (net of amounts capitalized)	<u>\$2,000,000</u>	<u>\$1,800,000</u>
Income taxes	<u>\$789,000</u>	<u>\$634,300</u>

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

ABC Casinos, Inc.
Notes to Financial Statements

1. Nature of Operations

ABC Casinos, Inc. (the Company) offers gaming, lodging, and restaurant services to its customers through the ownership and/or operation of casino-hotel resorts in Las Vegas, Nevada and Tunica, Mississippi. The Company earns a portion of its revenue from the management of casinos for other entities. The major source of the company's revenues is derived from gaming operations. The company is subject to regulation and taxation by the states in which it operates, generally managed through state agencies specifically established to control the conduct of gaming activities in that state. The company is subject to certain other local and federal regulations as well.

2. Summary of Significant Accounting Policies

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. Significant estimates for the Company include the allowance for uncollectible accounts receivable; useful lives assigned to property, plant, and equipment; and loyalty program costs.

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.

Management fee revenue. Classified within "other revenue" in the accompanying statement of income.

Revenue recognition and promotional allowances. Gaming revenue is (a) the win from gaming activities, which is the difference between gaming wins and losses, less sales incentives and other adjustments, and (b) revenue from gaming related activities such as poker, pari-mutuel wagering, and tournaments. Jackpots, other than the incremental amount of progressive jackpots, are recognized at the time they are won by customers. The Company accrues the incremental amount of progressive jackpots as the progressive machine is played, and the progressive jackpot amount increases, with a corresponding reduction of gaming revenue. The retail value of accommodations, food and beverage, and other services furnished to hotel-casino guests without charge is included in gross revenue and then deducted as promotional allowances.

Participation and third party license arrangements. The Company leases some of its slot machines from gaming equipment manufacturers under participation arrangements, whereby the gaming manufacturer receives a percentage of the *handle* or net win associated with the leased machine. The Company also pays third party license fees for proprietary games. Fees paid under participation arrangements and third party license arrangements are recorded as a gaming department expense.

Gaming taxes. In certain states in which the company operates, gaming taxes are based on graduated rates. The company records gaming tax expense at

the company's estimated effective gaming tax rate for the year, considering estimated taxable gaming revenue and the applicable rates. Such estimates are adjusted each interim period. If gaming tax rates change during the year, such changes are applied prospectively in the determination of gaming tax expense in future interim periods.

Loyalty programs. The company provides a players club (the Club) for its casino customers. Members of the Club earn points based on gaming activity, and such points are redeemable for cash, free play, or complimentary goods and services such as rooms, food, beverage, and so forth. Club members may also earn special coupons or awards as determined during marketing promotions. Because redemption of points does not displace a significant number of paying customers and the value of the awards is not significant compared to the original revenue transaction, the company records revenue for the original transaction and a liability for the value of points earned by Club members. The value of the points is determined by referencing the cash value of points expected to be redeemed for cash or free play and the incremental (departmental) cost of points expected to be redeemed for complimentary goods or services. The liability is reduced by points not expected to be redeemed (breakage). The cost of points redeemed for cash is recorded as a reduction of gaming revenue, and the cost of points redeemed for complimentary goods or services is recorded as an operating expense of the gaming department.

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 as follows:

Land improvements	30–40 years
Buildings	40 years
Furniture and equipment	3–7 years

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.

Investment securities. Realized gains and losses are included in other income or expense. The cost of securities sold is based on the specific identification method.

Other assets and deferred charges, net. Other assets and deferred charges, net at December 31, 2011 and 2010, includes \$400,000 and \$500,000, respectively, of management contract acquisition costs in connection with the management of gaming operations for third parties. Such costs are being amortized over the term of the related management agreement.

Advertising expenses. Advertising costs are expensed as incurred. Selling, general, and administrative expenses included advertising costs of \$650,000 and \$725,000 for the fiscal years ended December 31, 2011 and 2010, respectively.

3. Accounts Receivable

Accounts receivable comprise the following:

	<u>Gaming</u>	<u>Other</u>	<u>Total</u>
<u>2011</u>			
Accounts receivable	\$2,050,100	\$250,000	\$2,300,100
Less allowance for doubtful accounts	<u>(440,000)</u>	<u>(60,000)</u>	<u>(500,000)</u>
Net	<u>\$1,610,100</u>	<u>\$190,000</u>	<u>\$1,800,100</u>
<u>2010</u>			
Accounts receivable	\$1,994,200	\$171,000	\$2,165,200
Less allowance for doubtful accounts	<u>(431,000)</u>	<u>(39,000)</u>	<u>(470,000)</u>
Net	<u>\$1,563,200</u>	<u>\$132,000</u>	<u>\$1,695,200</u>

Receivables consist primarily of large groups of smaller-balance homogeneous accounts that are collectively evaluated for impairment.

4. Promotional Allowances

The retail value of rooms, food, and beverages furnished to guests without charge is included in gross revenue and then deducted as promotional allowances.

The following table includes the amount of promotional allowances by operating area:

	<u>2011</u>	<u>2010</u>
Rooms	\$1,000,000	\$900,000
Food and beverage	800,000	600,500
Other	<u>309,400</u>	<u>357,900</u>
Total	<u>\$2,109,400</u>	<u>\$1,858,400</u>

5. Long-Term Debt

Long-term debt is summarized as follows:

	<u>2011</u>	<u>2010</u>
Notes payable to banks, 1/4 to 3/4 over prime and 8% to 9%, payable in varying installments to 2016	\$8,800,000	\$9,100,000
Notes payable to institutional lenders, 5 1/4% to 10 1/2%, payable to 2016, of which \$11,786,000 is secured by real property	3,500,000	3,800,000
Notes payable, other, 1% over prime, payable to 2016	<u>4,500,000</u>	<u>4,600,000</u>
Total long-term debt	16,800,000	17,500,000
Less current installments of long-term debt	<u>(1,000,000)</u>	<u>(700,000)</u>
Net long-term debt	<u>\$15,800,000</u>	<u>\$16,800,000</u>

The aggregate amounts of principal maturities of debt outstanding at December 31, 2011, for the five subsequent years are as follows:

2012	\$1,000,000
2013	3,957,000
2014	2,991,000
2015	4,896,000
2016	<u>3,956,000</u>
	<u>\$16,800,000</u>

6. Fair Value of Financial Instruments^{1,2}

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 \$15,465,000 (2010, \$15,845,000).

7. Property and Equipment

In conjunction with plans to expand the casino floor space at one of the Company's Las Vegas casinos, in 2011, the Company determined that a portion of the furniture and equipment at the facility would be replaced. The Company has reviewed the estimated depreciable lives of the affected assets and shortened the lives based on the estimated timing of the expansion.

¹ Readers may refer to Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 825-10-50, as explained in FASB ASC 825, *Financial Instruments*, for guidance relating to this disclosure for a nonpublic entity.

² The guidance in FASB ASC 820, *Fair Value Measurements and Disclosures*, explains the established framework for determining fair value based on a hierarchy, with the most desirable evidence of fair value being quoted prices in active markets for identical assets and liabilities and the least desirable evidence being unobservable inputs (such as in a discounted cash flow model).

Governmental Gaming Entity

Illustrative financial statements and footnotes of a *governmental gaming entity* directly follow the Independent Auditor's Report.

Independent Auditor's Report

XYZ Tribal Council

We have audited the accompanying balance sheets of XYZ Casino (the Casino), an enterprise fund of the XYZ Tribe (the Tribe), as of December 31, 2011 and 2010, and the related statements of revenues, expenses, and changes in equity and cash flows and for the years then ended. These financial statements are the responsibility of 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.³ Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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.

As discussed in Note 1, the accompanying financial statements present only XYZ Casino and do not purport to, and do not present fairly, the financial position of the XYZ Tribe as of December 31, 2011 and 2010, and the changes in its financial position and, where applicable, cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.⁴

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of XYZ Casino as of December 31, 2011 and 2010, and the changes in its financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.⁵

[Firm Signature]

Certified Public Accountants

City, State

February 18, 2012

³ Governmental gaming entities may be required to have their financial statements audited in accordance with *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States. In addition, auditors may hold themselves out as following *Government Auditing Standards*. The AICPA Audit Guide *Government Auditing Standards and Circular A-133 Audits* contains detailed guidance regarding *Government Auditing Standards*, including its eight financial reporting standards, in addition to those in generally accepted auditing standards.

⁴ This paragraph, and the related financial statement disclosure, is not required for discretely presented component units.

⁵ As discussed in paragraph 12.06, the Governmental Accounting Standards Board requires financial statements prepared in accordance with accounting principles generally accepted in the United States of America to be accompanied by management's discussion and analysis. When required supplementary information is presented outside the basic financial statements in an auditor-submitted document, the auditor should (a) express an opinion on the information if engaged to examine the information; (b) report on such information using the guidance in paragraphs .12 and .14 of AU section 551A, *Reporting on Information Accompanying the Basic Financial*

(continued)

XYZ Casino⁶
Balance Sheets*

	<i>December 31,</i>	
	<u>2011</u>	<u>2010</u>
Assets		
Current assets		
Cash and cash equivalents	\$5,678,300	\$3,787,100
Receivables, 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	<u>7,719,100</u>	<u>5,711,400</u>
Capital assets, net of accumulated depreciation	30,383,900	31,697,615
Other assets and deferred charges	1,300,000	1,200,000
Total assets	<u>\$39,403,000</u>	<u>\$38,609,015</u>
Liabilities and Equity		
Current liabilities		
Current portion of long-term debt	\$1,000,000	\$700,000
Accounts payable	928,600	839,200
Other current liabilities	944,475	743,600
Total current liabilities	2,873,075	2,282,800
Long-term debt	15,800,000	16,800,000
Other	618,125	501,000
Total liabilities	<u>19,291,200</u>	<u>19,583,800</u>
Equity		
Invested in capital assets, net of related debt	13,583,900	14,197,615
Unrestricted	6,527,900	4,827,600
Total equity	<u>20,111,800</u>	<u>19,025,215</u>
Total liabilities and equity	<u>\$39,403,000</u>	<u>\$38,609,015</u>

(footnote continued)

Statements in Auditor-Submitted Documents (AICPA, Professional Standards), provided such information has been subjected to the auditing procedures applied in the audit of the basic financial statements; or (c) disclaim an opinion on the information (see paragraphs .15–.16 of AU section 551A). Effective for periods beginning after December 15, 2010, or upon early application of Statement on Auditing Standards No. 120, Required Supplementary Information (AICPA, Professional Standards, AU sec. 558), the guidance in AU section 558 would apply.

⁶ As required by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, the financial statements would be preceded by management's discussion and analysis, which is not presented here.

* In November 2010, GASB issued an exposure draft of a proposed statement, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. If adopted, the proposed statement would provide guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. Additionally, the proposed statement includes related amendments to the requirements of GASB Statement No. 34 and other pronouncements. The proposed effective date is for financial statements for periods beginning after June 15, 2011. Readers should be alert for the issuance of the final standard. The exposure draft may be found at www.gasb.org.

XYZ Casino
Statements of Revenues, Expenses, and Changes in Equity

*For the Years Ended
December 31,*

	2011	2010
Operating Revenues⁷		
Gaming	\$13,802,300	\$12,532,100
Rooms	2,100,600	1,927,200
Food and beverage	1,300,300	1,139,700
Other	690,600	542,100
Total operating revenues	17,893,800	16,141,100
Operating Expenses		
Gaming	4,012,100	3,717,600
Rooms	1,800,000	1,600,000
Food and beverage	1,500,000	1,200,000
Other	400,000	300,000
Selling, general, and administrative	3,021,900	2,707,700
State revenue sharing	970,200	818,000
Depreciation	2,602,715	2,597,431
Total operating expenses	14,306,915	12,940,731
Operating income	3,586,885	3,200,369
Nonoperating Revenues (Expenses)		
Interest expense	(2,050,300)	(1,935,300)
Total nonoperating revenues (expenses)	(2,050,300)	(1,935,300)
Income before transfers	1,536,585	1,265,069
Transfers to XYZ tribe^{8,9}		
Gaming taxes and regulation	250,000	250,000
Other	200,000	200,000
	450,000	450,000
Change in equity	1,086,585	815,069
Equity, beginning of year	19,025,215	18,210,146
Equity, end of year	\$20,811,800	\$19,025,215

⁷ See illustrative financial statements for nongovernmental entity for alternative acceptable presentation of promotional allowances.

⁸ Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, paragraphs 61 and 112 specify that resource flows within the primary government are classified as internal activity; therefore, gaming taxes and other amounts paid to the sponsoring government are reported as transfers. However, GASB Statement No. 34 paragraph 61 provides that resource flows (except those that affect the balance sheet only, such as loans and repayments) between a primary government and its discretely presented component units should be reported as if they were external transactions—that is, as revenues and expenses. The resulting revenue or expense should be reported as nonoperating revenue or expense, below operating income on the casino's statement of revenues, expenses, and changes in equity.

⁹ If present, capital contributions and distributions would be reported in this section, and the preceding subtotal would be labeled accordingly. Refer to paragraph 100 of GASB Statement No. 34.

XYZ Casino
Statements of Cash Flows¹⁰

	<i>For the Years Ended</i>	
	<i>December 31,</i>	
	<u>2011</u>	<u>2010</u>
Cash flows from operating activities		
Cash received from customers	\$17,788,900	\$16,932,406
Cash paid to vendors	(3,091,559)	(2,900,758)
Cash paid to employees	(7,396,941)	(7,130,721)
Payment of state revenue sharing	(970,200)	(890,127)
Net cash provided by operating activities	<u>6,330,200</u>	<u>6,010,800</u>
Cash flows from noncapital financing activities		
Transfers to XYZ Tribe	(450,000)	(450,000)
Net cash used in noncapital financing activities	(450,000)	(450,000)
Cash flows from capital and related financing activities		
Purchases of capital assets	(1,295,200)	(435,200)
Proceeds from sales of capital assets	6,200	437,300
Principal payments on long-term debt	(700,000)	(1,000,000)
Interest paid on debt	(2,000,000)	(1,935,300)
Net cash used in capital and related financing activities	(3,989,000)	(2,933,200)
Net increase in cash and cash equivalents	1,891,200	2,627,600
Cash and cash equivalents, beginning of year	3,787,100	1,159,500
Cash and cash equivalents, end of year	<u>\$5,678,300</u>	<u>\$3,787,100</u>

(continued)

¹⁰ The direct method of presenting cash flows from operating activities is required by paragraph 105 of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*.

	<i>For the Years Ended December 31,</i>	
	<u>2011</u>	<u>2010</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$3,586,885	\$3,200,369
Adjustments to reconcile net operating income to net cash provided by operating activities		
Depreciation	2,602,715	2,597,431
Provisions for doubtful accounts	30,000	20,000
Change in assets and liabilities		
Accounts receivable	(134,900)	(134,400)
Other assets	(111,600)	27,500
Accounts payable	89,400	38,500
Other current liabilities	150,575	55,900
Other long-term liabilities	117,125	205,500
Net cash provided by operating activities	<u>\$6,330,200</u>	<u>\$6,010,800</u>

XYZ Casino
Notes to Financial Statements
December 31, 2011 and 2010

1. Reporting Entity and Operations

XYZ Casino (the Casino) offers gaming, lodging, and restaurant services through the operation of a casino-hotel resort, which is an enterprise fund of the XYZ Tribe (the Tribe), a federally recognized Indian Tribe. As a wholly owned unincorporated business enterprise of the Tribe, the Casino is not a separate legal entity. The accompanying financial statements present only the Casino's financial position, changes in financial position, and cash flows. They do not purport to, and do not present fairly, the financial position of the Tribe and changes in its financial position and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.¹¹

The Tribe operates gaming activities as provided in a Tribal-State Compact (the Compact) pursuant to the Indian Gaming Regulatory Act of 1988 (IGRA), as approved by the U.S. Department of the Interior, Bureau of Indian Affairs. The Compact requires certain revenue sharing payments to the State based on a percentage of gross gaming revenue, less certain deductions. It has a seven-year term, which expires on September 25, 20XX. The Compact will automatically be extended for terms of seven years, unless the Tribe or the State provides written notice of nonrenewal.

The Tribe has established the XYZ Tribe Gaming Commission (the Gaming Commission) to regulate the gaming operations of the Casino. The Gaming Commission monitors the Casino's compliance with the Compact, the Tribe's gaming codes, the IGRA, and the rules and regulations of the National Indian Gaming Commission.

2. Summary of Significant Accounting Policies

In accordance with accounting principles generally accepted in the United States of America, the Casino applies all applicable pronouncements of the Governmental Accounting Standards Board (GASB), as well as the pronouncements of the Financial Accounting Standards Board (FASB) and Accounting Principles Board opinions and Accounting Research Bulletins issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements.

Basis of Accounting

The Casino's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned, and expenses are recorded when liabilities are incurred, regardless of when the related cash flow takes place.

Operating revenues result from providing services and goods in connection with the Casino's principal ongoing operations. Operating expenses include the cost of sales and services, general administrative and sales and marketing expenses, and depreciation on capital assets. Revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

¹¹ This disclosure is not required for discretely presented component units.

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. Significant estimates include the allowance for uncollectible accounts receivable; useful lives assigned to capital assets; and loyalty program costs.

Cash and Cash Equivalents

The Casino considers all highly liquid investments with a maturity of three months or less when purchased, including overnight repurchase agreements and money market funds, to be cash equivalents.

Inventories

Inventories consisting primarily of food and beverage stock, gaming machine parts, uniforms, and gift shop items are stated at the lower of cost or market. Cost is determined using the first-in, first-out method of inventory valuation.

Capital Assets

Capital assets are stated at cost. Depreciation and amortization of property and equipment are computed using the straight-line method over the estimated useful lives of the related assets as follows:

Land improvements	30–40 years
Buildings	40 years
Furniture and equipment	3–7 years

Leasehold improvements are amortized over the life of the related asset or the life of the lease, whichever is shorter.

The XYZ Tribal Council has approved the use of certain reservation land by the Casino. The Casino does not pay rent for the use of such land, and it remains in trust for the benefit of the Tribe.

Revenue Recognition and Promotional Allowances

Gaming revenue is (a) the win from gaming activities, which is the difference between gaming wins and losses, less sales incentives and other adjustments and (b) revenue from gaming related activities such as poker, pari-mutuel wagering, and tournaments. Jackpots, other than the incremental amount of progressive jackpots, are recognized at the time they are won by customers. The Casino accrues the incremental amount of progressive jackpots as the progressive machine is played and the progressive jackpot amount increases, with a corresponding reduction of gaming revenue. The retail value of accommodations, food and beverage, and other services furnished to hotel-casino guests without charge is not included in revenue.

Participation and Third-Party-License Arrangements

The Casino leases some of its slot machines from gaming equipment manufacturers under participation arrangements, whereby the gaming manufacturer receives a percentage of the handle or net win associated with the leased machine. The Casino also pays third-party license fees for proprietary games. Fees

paid under participation arrangements and third-party license arrangements are recorded as a gaming department expense.

Loyalty Program

The Casino provides a players club (the Club) for its customers. Members of the Club earn points based on gaming activity, and such points are redeemable for cash, free play, or complimentary goods and services such as rooms, food, beverage, and so forth. Club members may also earn special coupons or awards as determined during marketing promotions. Because redemption of points does not displace a significant number of paying customers and the value of the awards is not significant compared to the original revenue transaction, the Casino records revenue for the original transaction and a liability for the value of points earned by Club members. The value of the points is determined by referencing the cash value of points expected to be redeemed for cash or free play and the incremental (departmental) cost of points expected to be redeemed for complimentary goods or services. The liability is reduced by points not expected to be redeemed (breakage). The cost of points redeemed for cash is recorded as a reduction of gaming revenue, and the cost of points redeemed for complimentary goods or services is recorded as an operating expense of the gaming department.

Advertising Costs

Advertising costs are expensed as incurred. Sales and marketing expenses included advertising costs of \$650,000 and \$725,000 for the fiscal years ended December 31, 2011 and 2010, respectively.

Income Taxes

As an enterprise owned by the XYZ Tribe, a federally recognized Indian Tribe, the Casino is not subject to federal or state income taxes. Accordingly, no provision for income taxes is included in the accompanying financial statements.

3. Cash and Cash Equivalents

Cash and cash equivalents consisted of the following:

	<i>December 31,</i>	
	<u>2011</u>	<u>2010</u>
Demand deposits	\$3,350,938	\$1,489,028
Overnight repurchase agreements	1,082,362	661,172
Cash on hand	1,245,000	1,636,900
Total cash and cash equivalents	<u>\$5,678,300</u>	<u>\$3,787,100</u>

Custodial credit risk for demand deposits is the risk that in the event of a bank failure, the Casino's demand deposits may not be returned to it. The Casino does not have a deposit policy for custodial credit risk. The bank balances of demand deposits were \$3,421,098 and \$1,523,982 at December 31, 2011 and 2010, respectively. The bank balances were exposed to custodial credit risk except for \$300,000 of Federal Deposit Insurance Corporation coverage.

4. Accounts Receivable

Accounts receivable are from customers as follows:¹²

	<u>Gaming</u>	<u>Other</u>	<u>Total</u>
<u>2011</u>			
Accounts receivable	\$2,050,100	\$250,000	\$2,300,100
Less allowance for doubtful accounts	<u>440,000</u>	<u>60,000</u>	<u>500,000</u>
Net	<u>\$1,610,100</u>	<u>\$190,000</u>	<u>\$1,800,100</u>
<u>2010</u>			
Accounts receivable	\$1,994,200	\$171,000	\$2,165,200
Less allowance for doubtful accounts	<u>431,000</u>	<u>39,000</u>	<u>470,000</u>
Net	<u>\$1,563,200</u>	<u>\$132,000</u>	<u>\$1,695,200</u>

Receivables consist primarily of large groups of smaller-balance homogeneous accounts that are collectively evaluated for impairment.

5. Long-Term Debt

Long-term debt consists of notes payable by XYZ Tribe to various financial institutions summarized as follows:

	<u>2011</u>	<u>2010</u>
Notes payable to banks, 1/4–3/4 over prime and 8% to 9%, payable in varying installments to 2016	\$8,800,000	\$9,100,000
Notes payable to institutional lenders, 5 1/4% to 10 1/2%, payable to 2016	3,500,000	3,800,000
Notes payable, other, 1% over prime, payable to 2016	<u>4,500,000</u>	<u>4,600,000</u>
Total long-term debt	16,800,000	17,500,000
Less current installments of long-term debt	<u>1,000,000</u>	<u>700,000</u>
Net long-term debt	\$15,800,000	\$16,800,000

The debt is reported by the Casino because it is directly related to and expected to be paid by the Casino.¹³

¹² Paragraph 13 of Governmental Accounting Standards Board (GASB) Statement No. 38, *Certain Financial Statement Note Disclosures*, specifies that the notes to the financial statements should provide details when significant components of accounts receivable or accounts payable have been obscured by aggregation. Significant receivable balances not expected to be collected within one year of the date of the financial statements and receivables with different liquidity characteristics should be disclosed.

¹³ National Council of Governmental Accounting Statement No. 1 paragraph 42 specifies that enterprise funds report debt that is directly related to their activities and expected to be repaid by them, even though the debt may be an obligation of the government. Such debt need not be reported as a liability of discretely presented component units. If the debt is the legal responsibility of the government, it must be reported as a liability in the primary government financial statements of the governmental reporting entity.

Changes in long-term debt for the years ended December 31, 2011 and 2010, are summarized as follows:

	<u>20X7</u>	<u>20X6</u>
Beginning balance	\$17,500,000	\$18,500,000
Additions	—	—
Reductions	<u>700,000</u>	<u>1,000,000</u>
Ending balance	\$16,800,000	\$17,500,000

Annual debt service requirements of long-term debt at December 31, 2011, are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$1,000,000	\$1,141,000	\$2,141,000
2013	3,957,000	967,505	4,924,505
2014	2,991,000	724,325	3,715,325
2015	4,896,000	448,280	5,344,280
2016	<u>3,956,000</u>	<u>138,460</u>	<u>4,094,460</u>
	\$16,800,000	\$3,419,570	\$20,219,570

6. Capital Assets

Capital asset activity for the years ended December 31, 2011 and 2010, is summarized as follows:¹⁴

	<i>Year Ended December 31, 2011</i>			
	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Land improvements	\$2,201,100	\$—	\$—	\$2,201,100
Buildings	27,602,300	—	—	27,602,300
Furniture and equipment	8,995,200	1,295,200	709,300	9,581,100
	<u>38,798,600</u>	<u>1,295,200</u>	<u>709,300</u>	<u>39,384,500</u>
Less: accumulated depreciation				
Land improvements	870,290	55,028	—	925,318
Buildings	4,171,169	690,057	—	4,861,226
Furniture and equipment	2,059,526	1,857,630	703,100	3,214,056
	<u>7,100,985</u>	<u>2,602,715</u>	<u>703,100</u>	<u>9,000,600</u>
Capital assets, net	<u>\$31,697,615</u>	<u>\$(1,307,515)</u>	<u>\$6,200</u>	<u>\$30,383,900</u>

¹⁴ In this example, all capital assets are being depreciated. If the entity reported capital assets that were not subject to depreciation, such as land, they would be reported separately on the balance sheet in accordance with paragraph 20 of GASB Statement No. 34.

Gaming

Year Ended December 31, 2010

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Land improvements	\$2,201,100	\$—	\$—	\$2,201,100
Buildings	27,602,300	—	—	27,602,300
Furniture and equipment	<u>9,528,284</u>	<u>435,200</u>	<u>968,284</u>	<u>8,995,200</u>
	39,331,684	435,200	968,284	38,798,600
Less: accumulated depreciation				
Land				
improvements	815,262	55,028	—	870,290
Buildings	3,481,112	690,057	—	4,171,169
Furniture and equipment	<u>738,164</u>	<u>1,852,346</u>	<u>530,984</u>	<u>2,059,526</u>
	<u>5,034,538</u>	<u>2,597,431</u>	<u>530,984</u>	<u>7,100,9850</u>
Capital assets, net	<u>\$34,297,146</u>	<u>\$(2,162,231)</u>	<u>\$437,300</u>	<u>\$31,697,615</u>

In conjunction with plans to expand casino floor space, the Casino recently completed a slot machine upgrade, replacing a portion of its older slot machines with machines that contain embedded bill acceptors. The older machines, with a carrying amount of \$763,525 are in storage and may be placed back in service once the casino expansion is completed.

Appendix B

Illustrative Guidance When Accounting for Guarantees

Applicability: *This appendix provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.*

This appendix provides some examples of the accounting for guarantees under the guidance of Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 460, *Guarantees* (the primary accounting guidance for guarantees).

For additional details regarding the various computations and amounts used throughout the following examples, refer to the calculation tables in the back of this appendix.

Hypothetical Agreement Data

In all subsequent examples, an assumption is made that a gaming manager enters into an agreement to manage a casino operation, the *New Casino*, for an unrelated third party, the *Casino Owner*. As part of the agreement, the *Gaming Manager* agrees to guarantee a \$25,000,000 loan and any unpaid interest to be made to the Casino Owner by an unrelated third party bank to fund the development and start-up operations of New Casino. The debt (the loan) is secured by all the property and equipment owned by the Casino Owner. Additionally, the terms of the agreement provide, in part, that the Gaming Manager will perform the following functions:

- Provide direction to Casino Owner in setting up its operations in compliance with local gaming regulations
- Provide training to Casino Owner's employees
- Under the direction of Casino Owner, manage New Casino's day-to-day operations
- Serve as a consultant to Casino Owner on management and other issues

The agreements may stipulate a fee to be paid to the guarantor in exchange for providing the guarantee. In such instances, the guarantor must assess whether or not the contractual fee represents the fair value of the guarantee being provided. For purposes of the following examples, in which the consideration for the guarantee is a component of a multielement contract, it is assumed that the contract terms represent the economics of providing the guarantee to Casino Owner.

Initial Recognition and Measurement Examples

Example 1: When the agreement includes a provision for the reduction of management fees upon the termination of the guarantee.

Additional hypothetical data for example 1: The agreement provides that the Gaming Manager will be paid 10 percent of operating earnings (as defined in the agreement) by the Casino Owner for providing services under the agreement, including the guaranteeing of the debt. Further, the agreement provides that the management fee will be reduced from 10 percent to 7 percent if the Gaming Manager is no longer required to guarantee the Casino Owner's debt. The agreement, the debt, and the guarantee are all for 5-year periods. The loan (the debt) is due in a balloon payment at the end of year 5. The estimated operating earnings of the New Casino and the management fee to be paid to the Gaming Manager over the 5-year term of the agreement are as follows:

Table B-1

<i>Year</i>	<i>New Casino's projected operating earnings</i>	<i>Gaming Manager's estimated management fee (10%)</i>
1	\$7,700,000	\$770,000
2	8,000,000	800,000
3	8,350,000	835,000
4	8,600,000	860,000
5	9,000,000	900,000
Total	\$41,650,000	\$4,165,000

In example 1, the issuance of the guarantee obligates the Gaming Manager in two respects: (a) the Gaming Manager undertakes an obligation to stand ready to perform and (b) the Gaming Manager undertakes a contingent obligation to make future payments if certain triggering events or conditions occur. Thus, at inception, the Gaming Manager should recognize a liability for the greater of (a) the fair value of the guarantee, or (b) the contingent liability amount required to be recognized at inception of the guarantee provided by FASB ASC 450-20-25-2, as explained in FASB ASC 450, *Contingencies*. For purposes of this example, it is assumed that no evidence exists that it is probable that the Gaming Manager has incurred an estimated loss from a contingency pursuant to FASB ASC 450-20-25-2. As a result, the Gaming Manager should record the inception liability at fair value.

The management agreement provides that the management fee will be reduced from 10 percent to 7 percent if the Gaming Manager is no longer required to guarantee the Casino Owner's debt. Given this contractual provision, the present value of the estimated reduction in management fees that would occur (based on contracted amounts), if the manager is no longer required to provide the guarantee, may provide a reasonable estimate of how much of the total fee

should be allocated to the premium that would be required by the manager to issue the same guarantee in a stand-alone, arm's length transaction with an unrelated party. Based on the estimated management fees to be earned by the Gaming Manager over the term of the management agreement as outlined in the previous table, the portion of the total management fee ascribed to the premium for providing the guarantee may be reasonably estimated as follows:

Table B-2

Year	<i>New Casino's projected operating earnings</i>	<i>Gaming Manager's management fee arising from guarantee (3%)</i>	<i>Gaming Manager's estimated present value (using an assumed discount rate, rounded, of 5%)^{1,2}</i>
1	\$7,700,000	\$231,000	\$220,000
2	8,000,000	240,000	218,000
3	8,350,000	*251,000	216,000
4	8,600,000	258,000	212,000
5	9,000,000	270,000	212,000
Total	\$41,650,000	\$1,250,000	\$1,078,000

* Rounded to the nearest thousand.

¹ In accordance with FASB ASC 820, *Fair Value Measurements and Disclosures*, the estimated present value should be discounted using a risk adjusted market rate of interest.

² The 5% discount rate has been used for illustrative purposes only.

The estimated present value of the 3-percent projected management fee attributable to the guarantee over the 5-year life of the management agreement based on the Casino Owner's budgets is approximately \$1,078,000. The Gaming Manager believes that is a reasonable and appropriate measure of the fair value of the premium for providing the guarantee.

The Gaming Manager should record the following entry at the inception of the guarantee to recognize the fair value of the liability it assumed as a result of issuing the guarantee.

Dr	Contract acquisition cost asset	\$1,078,000
	Cr Guarantee liability	\$1,078,000

Example 2: When the agreement includes no provision for the reduction of management fees upon the termination of the guarantee.

Additional hypothetical data for example 2: The management agreement includes no provision for the reduction of management fees upon the termination of the guarantee. The loan issued to the Casino Owner by the bank and guaranteed by the Gaming Manager bears interest at 6 percent per annum. The bank asserts that the loan would bear interest at 7 percent per annum if the loan

was not guaranteed by the Gaming Manager, and that assertion is objective and verifiable.

In these circumstances, the premium can be estimated by calculating the present value of the incremental interest that would have been charged to the casino owner had the gaming manager not provided the guarantee. In this example, the estimated present value of the incremental interest charges that would have been paid by the casino owner, absent the guarantee, is approximately \$1,082,000. The gaming manager believes that is a reasonable and appropriate measure of the fair value of the premium for providing the guarantee.

The Gaming Manager will record the following entry at the inception of the guarantee:

Dr	Contract acquisition cost asset	\$1,082,000	
	Cr	Guarantee liability	\$1,082,000

Subsequent Measurement and Amortization Examples

Example 3: Reducing the liability and amortizing the asset using a straight-line method.

Additional hypothetical data for example 3: After giving initial accounting recognition to the liability and related asset arising from the issuance of the guarantee, the Gaming Manager in subsequent accounting periods (1) reduces the liability (as a credit to earnings as the Gaming Manager is released from risk under the guarantee), and (2) amortizes the intangible asset (a contract or customer acquisition cost) over its estimated useful life as a debit to management contract revenue. The release from risk under the guarantee is recognized over the term of the guarantee using a systematic and rational amortization method. The Gaming Manager concludes that both the liability and the asset should be amortized using the straight-line method. In year 1, using the data outlined in table B-1, assuming that payments are made pursuant to the management agreement as they are due, the Gaming Manager will make the following entries to reflect the aggregate management contract revenue earned, payments received, reduction of the liability pertaining to the guarantee, and amortization of the contract acquisition cost asset:

Dr	Cash	770,000	
	Cr	Management contract revenue (or other income)	770,000

To record cash received for management fees (equals New Casino's operating earnings, as defined in the agreement, of \$7,700,000 multiplied by 10%, including 3% fee for providing guarantee).

Dr	Guarantee liability	215,600	
	Cr	Management contract revenue (or other income)	215,600

To relieve the \$1,078,000 liability using the straight-line method based on 5-year life of the guarantee. (\$1,078,000 divided by 5 years equals \$215,600).

Dr	Management contract revenue (or other expense)	215,600
	Cr Contract acquisition cost asset	215,600

To amortize the \$1,078,000 contract acquisition cost asset using the straight-line method based on a 5-year life of the management agreement.

Example 3A: Reducing the liability proportionately as the debt is reduced and amortizing the asset using a straight-line method. In this example, the debt is paid down over time.

Additional hypothetical data for example 3A: In this example, the Gaming Manager (1) reduces the liability as a credit to earnings as the Gaming Manager is released from risk under the guarantee and (2) amortizes the contract acquisition cost asset over its estimated useful life as a debit to management contract revenue. In this example, the Gaming Manager concludes that the liability should be reduced proportionately as the debt is reduced, and the asset should be amortized using the straight-line method. In year 1, using the data in table B-1, except that interest is payable at 6 percent, and the loan is an amortizing 5-year loan with annual payments of principal and interest of \$5,935,000. It is also assumed that payments are made pursuant to the debt and management agreements as they are due. At the end of year 1, the Gaming Manager makes the following entries to reflect the aggregate management contract revenue earned, payments received, reduction of the liability pertaining to the guarantee, and amortization of the intangible asset.

Dr	Cash	770,000
	Cr Management contract revenue (or other income)	770,000

To record cash received equals New Casino's operating earnings, as defined in the agreement, of \$7,700,000 multiplied by 10% (including 3% fee for providing guarantee).

Dr	Guarantee liability	191,000
	Cr Management contract revenue (or other income)	191,000

To relieve the \$1,078,000 initial liability proportionately as the principal balance of the debt is reduced. (Yearly principal portion of the annual payment divided by the original loan balance multiplied by the contract acquisition cost asset, that is, year 1 $(\$4,435/\$25,000) \times \$1,078 = \191).

Dr	Management contract revenue (or other expense)	215,600
	Cr Contract acquisition cost asset	215,600

To amortize the \$1,078,000 contract acquisition cost asset using the straight-line method based on a 5-year life of the management agreement.

The preceding example depicts one systematic and rational method for the amortization of the liability arising from a debt guarantee. There are other systematic and rational methods to amortize the liability when the debt is being paid down over time.

Example 4: Early retirement of debt or termination of the guarantee.

Additional hypothetical data for example 4: In this example, assume facts and circumstances described in example 1 and that the Gaming Manager adopts the straight-line amortization method for reducing the guarantee liability and amortizing the asset (with a proportionate reduction of the liability if a portion of the debt is prepaid, or the manager is released from the guarantee obligation). After 4 years of applying this method, the contract acquisition cost asset and guarantee liability accounts each would have a balance of \$215,600 (equal to one-fifth of \$1,078,000). Further, assume that at the end of year 4 that the bank releases the gaming manager from its obligation, and the management fee will be reduced from 10 percent to 7 percent. The gaming manager should make the following entry to reduce the guarantee liability to zero because the guarantee no longer exists:

Dr	Guarantee liability	215,600	
	Cr	Management contract revenue (or other income)	215,600

To eliminate the guarantee liability balance against revenue because the guarantee (and related liability) no longer exists.

The Gaming Manager will not make an entry to adjust the contract acquisition cost asset because the management contract remains in place, and revenues will continue to be earned over the remaining term of the contract. The Gaming Manager should continue to amortize the intangible asset over the remaining term of the contract.¹

Example 5: Debt is refinanced prior to maturity with new lender.

Additional hypothetical data for example 5: In this example, assume the facts and circumstances described in example 1, except that at the end of year 4, in connection with a planned expansion of the casino facility, Casino Owner refinances the debt and funds its expansion via a new \$50 million loan from a new lender guaranteed by the Gaming Manager. Upon retirement of the existing loan, the original lender releases the Gaming Manager from his or her obligation under the original guarantee. In exchange for the new guarantee, the Casino Owner agrees to extend the management contract with the Gaming Manager for 4 additional years. No change is made to the management fee.

¹ Pursuant to Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 360-10-35-21, as explained in FASB ASC 360, *Property, Plant, and Equipment*, the reduction in management fees would be a change in circumstances indicating that the carrying amount of the contract acquisition cost asset may not be recoverable. Accordingly, the customer acquisition cost asset (asset group) should be tested for impairment in conformity with FASB ASC 360. This example assumes no such impairment exists.

In such circumstances, two transactions have occurred and are accounted for separately. The first transaction is the termination of the guarantee, similar to the transaction described in example 4. The second transaction is the issuance of the new guarantee in exchange for the extension of the management contract.

As a result of the termination of the original guarantee, the Gaming Manager should make the following entry to reduce the guarantee liability to zero because the original guarantee no longer exists:

Dr	Guarantee liability	215,600	
	Cr	Management contract revenue (or other income)	215,600

To eliminate the guarantee liability balance against revenue because the original guarantee (and related liability) no longer exists.

Given that the portion of the management fee attributable to providing the guarantee in future periods is used to support the contract acquisition asset recognized in the following entry, the Gaming Manager should also write off the remaining balance of the existing contract acquisition asset due to the modification of the agreement (see example 9.)

Dr	Management contract revenue (or other expense)	215,600	
	Cr	Contract acquisition cost asset	215,600

To write off the remaining balance of the intangible asset [(\$1,078,000 initially reported - \$862,400 amortized to date) = \$215,600 balance after year 4] as a result of the modification of the agreement.

The Gaming Manager would then calculate the fair value of the new guarantee pursuant to the terms of the new agreement and record a new contract acquisition cost asset and new guarantee liability as described in example 1. The asset and liability would be amortized over the lives of the modified management contract and the new guarantee, respectively.

Example 6: Change in expected operating results—it is probable that the Casino Owner will default.

Additional hypothetical data for example 6: In this example, assume facts and circumstances described in example 1, except that that the loan is an amortizing 5-year loan with annual principal payments. The Gaming Manager concludes that both the guarantee liability and the intangible asset should be amortized using the straight-line method. Further, assume that as of the end of year 1, the Casino Owner has made no debt payments and, based on operating results to date and management estimates, the Gaming Manager concludes that it is probable that the Casino Owner will default on the debt; the bank will demand that the Gaming Manager satisfy the debt; the Casino Owner will go out of business; and the management agreement will not be fulfilled. In this circumstance, the Gaming Manager has incurred an estimated loss from a contingency pursuant to FASB ASC 450-20-25-2 for having to perform under the guarantee. In addition, the Gaming Manager has incurred an impairment loss pursuant to FASB ASC 360, *Property, Plant, and Equipment*, for the contract acquisition cost asset (asset group). The contract acquisition cost asset should

be eliminated and an impairment loss reported in conformity with FASB ASC 360, including related financial statement disclosures. The Gaming Manager should make the following entries:

Dr	Impairment loss	862,400	
	Cr	Contract acquisition cost asset	862,400

To report an impairment loss pursuant to FASB ASC 360 and, therefore, eliminate the intangible asset balance [\$1,078,000 initially reported - \$215,600 relieved to date].

Dr	Guarantee liability	\$862,400	
Dr	Loss on guarantee	24,137,600	
	Cr	Contingent liability	\$25,000,000

To report a loss for the amount of the guaranteed debt in excess of the guarantee liability.

Example 7: A change in the expected operating results—the Casino Owner performs better than expected.

Additional hypothetical data for example 7: In this example, the gaming manager is reducing the guarantee liability on a straight-line basis over the 5-year period of the original guarantee (with a proportionate reduction of the liability if a portion of the debt is prepaid, or the manager is released from the guarantee obligation), similar to the fact pattern in example 3. After year 1, based on better than expected operating results to date and management estimates, the Gaming Manager concludes that it is likely that it will be released from the guarantee after year 2, and that the fair value of the guarantee will be significantly less than originally estimated at inception. The Gaming Manager considers reducing the liability on an accelerated basis (beyond amounts that would be reported by reducing the liability on a straight-line basis over the 5-year period of the original guarantee) because its risk has been significantly reduced beyond amounts that would be reported based on a straight-line calculation. The Gaming Manager concludes, however, that it should not reduce the liability on an accelerated basis, consistent with FASB ASC 460-10-35-2, as explained in FASB ASC 460.² The Gaming Manager, therefore, continues to consistently apply the straight-line method for reducing the liability over the life of the debt. Upon its actual release from the guarantee, the Gaming Manager would relieve the remaining balance of the liability to revenue. The accounting for the contract acquisition cost asset will remain the same as it was prior to concluding that it is likely that it will be released from the guarantee after year 2, unless and until the management agreement is revised.

² FASB ASC 460-10-35-2 provides that a guarantor should not use fair value in subsequently accounting for the liability for its obligations under a previously issued guarantee unless the use of that method can be justified under generally accepted accounting principles, as is the case, for example, for guarantees accounted for as derivatives under FASB ASC 815, *Derivatives and Hedging*, or in the case in which the guarantor has adopted and applied the provisions of FASB ASC 825, *Financial Instruments*, to the guarantee liability.

Example 8: A change in the expected operating results—the Casino Owner prepays a portion of the debt, and the Gaming Manager is reducing the liability using a straight-line method (with a proportionate reduction of the liability if a portion of the debt is prepaid or the Gaming Manager is released from the guarantee obligation).

Additional hypothetical data for example 8: In this example, the Gaming Manager is reducing the guarantee liability on a straight-line basis, similar to the fact pattern in example 3, over the 5-year period of the original guarantee (with a proportionate reduction of the liability if a portion of the debt is prepaid, or the manager is released from the guarantee obligation). Assume that after year 1, because of better than expected operating results to date, management estimates, and falling interest rates, the Casino Owner prepays a portion of the debt (\$20,000,000) so that only \$5,000,000 of the original \$25,000,000 loan is outstanding at the beginning of year 2. The guarantee and related fees, however, remain unchanged. The Gaming Manager should reduce the liability on an accelerated basis (to reflect proportionate reduction of the liability because a portion of the debt is prepaid) to \$172,480 [$\$1,078,000$ initial liability \times (5/25 debt balance remaining) \times (4/5 unamortized portion of liability)], with an offsetting credit to management contract revenue. The contract acquisition cost asset will not be reduced because there is no alteration of the management agreement. The reduction of the liability without reducing the intangible asset accelerates revenue recognition, effectively recognizing the estimated reduction in risk as a revenue-producing event (guaranteeing only \$5,000,000 of debt versus \$25,000,000 of debt). The Gaming Manager should make the following entry:

Dr	Guarantee liability	689,920
Cr	Management contract revenue (or other income)	689,920

To reduce the guarantee liability to represent the \$172,480 adjusted balance of the guarantee (\$862,400 balance before adjustment, less \$172,480 balance equals \$689,920 adjustment required.).

Example 8A: A change in the expected operating results—the Casino Owner repays a portion of the debt, and the Gaming Manager reducing the liability on a straight-line basis.

Additional hypothetical data for example 8A: In this example, the Gaming Manager is reducing the guarantee liability on a straight-line basis, over the 5-year period of the original guarantee, (with no proportionate reduction of the liability if a portion of the debt is prepaid because the Gaming Manager believes its obligation is to stand ready to perform over a period of time and is, therefore, not directly correlated with the debt balance,) similar to the fact pattern in example 3. Further, assume that after year 1, because of better than expected operating results to date, management estimates, and falling interest rates, the Casino Owner prepays a portion of the debt (\$20,000,000), so that only \$5,000,000 of the original \$25,000,000 loan is outstanding at the beginning of year 2. The guarantee and related fees, however, remain unchanged. Given that the Gaming Manager's accounting policy is to reduce the liability on a

straight-line basis, the liability should not be reduced on an accelerated basis. Also, the contract acquisition cost asset should not be reduced because no changes in fees are expected to result from the Casino Owner prepaying a portion of the debt.

Example 9: Modification to the management agreement.

Additional hypothetical data for example 9: In this example, the Gaming Manager is reducing the guarantee liability on a straight-line basis over the 5-year period of the original guarantee (with a proportionate reduction of the liability if a portion of the debt is prepaid, or the manager is released from the guarantee obligation), similar to the fact pattern in example 3A, and the guarantee agreement does not include a provision for the reduction in management fees upon termination of the guarantee, similar to example 2. Further, assume that at the end of year 2, the Casino Owner refinances the debt, and the Gaming Manager's guarantee is terminated. In addition, the agreement between the Casino Owner and the Gaming Manager is renegotiated to reduce the management fees by 3 percentage points. The Gaming Manager should write off the liability stemming from the guarantee and recognize management contract revenue. The Gaming Manager should also write off the remaining balance of the intangible asset because the asset would be impaired under FASB ASC 360. Assume 2 years of amortization have already occurred. The Gaming Manager should make the following entries:

Dr	Guarantee liability	646,800	
	Cr	Management contract revenue (or other income)	646,800

To reduce the guarantee liability to zero [(\$1,078,000 initially reported, less \$431,200 ($\$1,078,000 \times 2/5$) amortized to date, equals \$646,800 balance after year 2].

Dr	Management contract revenue (or other income)	646,800	
	Cr	Contract acquisition cost asset	646,800

To write off the remaining balance of the intangible asset (\$1,078,000 initially reported, less \$431,200 amortized to date, equals \$646,800 balance after year 2,) as a result of the modification of the agreement.

Example 10: Financial statement disclosures.

Considering the facts and circumstances as described in examples 1 and 3, the Gaming Manager's financial statements at the end of year 2 would contain the following disclosure regarding its guarantee of the Casino Owner's debt:

As part of the agreement under which we manage the facility owned by the Casino Owner, we guaranteed the debt incurred by the Casino Owner to construct its casino property. The outstanding balance of the guaranteed debt as of the end of year 2 was \$25 million. We have obtained a second lien on certain real property of the casino enterprise. There can be no assurance, however, that the value of such property would satisfy our obligations in the event these guarantees were enforced. In accordance with the requirements of FASB ASC 460, we

recognized a liability for the estimated fair value of the guarantee at its inception. A liability, representing the fair value of our guarantees, and a corresponding contract acquisition cost asset were recorded and are being amortized over on a straight-line basis over the life of the related agreements. We estimated the fair value of the obligation by considering what premium would have been required by us or by an unrelated party. The amounts recognized represent the present value of the premium in interest rates and fees that would have been charged to the Casino Manager if we had not provided the guarantee. The balance of the liability for the guarantees and of the related assets at the end of year 2 was \$646,800.

Calculation Tables

The information in the following tables has been used throughout the examples contained in this appendix. Some general information applicable to the tables is as follows:

Original debt balance:	\$25,000,000
Original management fee:	10%
Management fee reduction upon the elimination of the guarantee:	3%
Stated interest rate:	6%
Interest rate without the guarantee:	7%
Initial measurement of the guaranty liability:	\$1,078,000

The initial measurement of the guarantee value by the contractual reduction in the management fee was computed as follows (amounts are in thousands):

<i>Year</i>	<i>Estimated operating earnings</i>	<i>Estimated management fee (10%)</i>	<i>Fee increment for providing guarantee (3%)</i>	<i>Discounted at 5% annually</i>	<i>Discounted amount of fee increment</i>
1	\$7,700	\$770	\$231	0.9524	\$220
2	8,000	800	240	0.9070	218
3	8,350	835	251	0.8638	216
4	8,600	860	258	0.8227	212
5	9,000	900	270	0.7835	212
	<u>\$41,650</u>	<u>\$4,165</u>	<u>\$1,250</u>		<u>\$1,078</u>

The initial measurement of the difference in the interest rate charged in the absence of the guarantee was computed as follows (amounts are in thousands):

Year	<i>Annual Interest</i>		<i>Difference</i>	<i>Discounted at 5% Annually</i>	<i>Discounted Value</i>
	<i>Stated Interest</i>	<i>Without Guarantee</i>			
1	\$1,500	\$1,750	\$250	0.9524	\$238
2	1,500	1,750	250	0.9070	227
3	1,500	1,750	250	0.8638	216
4	1,500	1,750	250	0.8227	206
5	1,500	1,750	250	0.7835	196
					<u>\$1,082</u>

Various calculations of the guarantee liability amortization were computed as follows (amounts are in thousands):

<i>Year at Inception</i>	<i>Loan Balance</i>	<i>Total Annual Payment</i>	<i>Principal Portion of Payment</i>	<i>Remaining Principal Balance</i>	<i>Straight Line Amortization of the Liability</i>
				\$25,000	
1	\$25,000	\$(5,935)	\$(4,435)	20,565	\$215.6
2	20,000	(5,935)	(4,701)	15,299	215.6
3	15,000	(5,935)	(4,983)	10,017	215.6
4	10,000	(5,935)	(5,282)	4,718	215.6
5	5,000	(5,935)	(5,599)	—	215.6
			<u>\$(25,000)</u>		<u>\$1,078</u>

Various calculations of the contract acquisition cost asset were computed as follows (amounts are in thousands):

Year	<i>Estimated Operating Earnings</i>	<i>Management Fee (10%)</i>	<i>Annual Amortization Straight-Line Method</i>
1	\$7,700	\$770	\$215.6
2	8,000	800	215.6
3	8,350	835	215.6
4	8,600	860	215.6
5	9,000	900	215.6
		<u>\$4,165</u>	<u>\$1,078</u>

Appendix C

The New Jersey Casino Reinvestment Development Authority

Applicability: *This appendix provides guidance applicable to non-governmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," of this guide and consider the implications of Governmental Accounting Standards Board pronouncements that conflict with or contradict guidance provided in this chapter.*

The guidance in this appendix applies to casinos licensed in the state of New Jersey and subject to the requirements of the New Jersey Casino Reinvestment Development Authority (CRDA). If a casino is subject to similar arrangements in other jurisdictions, consider following the guidance in this appendix to the extent that it is relevant.

Background

Casinos operating in the state of New Jersey are subject to the requirements of the CRDA. The purpose of the CRDA is to maintain public confidence in the casino gaming industry as a unique tool of urban redevelopment; to provide licensees with an effective method of encouraging new capital investment in the surrounding areas; to further and promote tourism industries; and to provide loans and other financial assistance for the development of low income housing. The requirements of the CRDA are an ongoing responsibility with annual investment requirements.¹

Under New Jersey law, casino licensees have the option of either (1) paying a percentage of their gross gaming revenues to the CRDA as a tax, or (2) investing the same amount in "obligation deposits" (defined in the following text) of the CRDA. Generally, most licensees in New Jersey elect to invest a percentage of their gross revenues in obligation deposits of the CRDA rather than pay the tax.

Summary of Selected Accounting Concepts and Literature

Arrangements to invest in obligation deposits should be assessed for their substance. The arrangements may include elements that are effectively a gaming tax, and such elements should be accounted for as an expense. The multiple elements of the arrangement generally should be accounted for at their fair value.

The primary accounting literature relating to investments in obligation deposits of the CRDA is Financial Accounting Standards Board (FASB)

¹ For additional information regarding the New Jersey Casino Control Commission and the New Jersey Casino Control Act, including Article 12 (5:12-160) of the act, readers may go online to www.state.nj.us/casinos/.

Accounting Standards Codification (ASC) 320, Investments—Debt and Equity Securities; FASB ASC 820, Fair Value Measurements and Disclosures; FASB ASC 310, Receivables; and FASB Concepts Statement No. 6, Elements of Financial Statements.

Obligation Deposits

The amounts invested in obligation deposits are restricted assets owned by the casino licensee (Licensee). The Licensee can use the obligation deposits to either (1) purchase bonds issued by the CRDA or (2) make direct investments in projects approved by the CRDA, including improvements to the Licensee's assets or infrastructure improvement projects in Atlantic City or elsewhere in the state of New Jersey (commonly referred to as *direct investments*). The Licensee can elect to allocate its obligation deposits to bonds, direct investments approved by the CRDA, or any combination thereof.

Obligation deposits are due quarterly. Interest is earned at the stated rate that approximates two-thirds of the current market interest rate for liquid, low risk investments, such as money market funds. Interest earned by the Licensee is taxable to the Licensee and is deposited in the Licensee's obligation deposit account.

CRDA Bonds²

CRDA bonds typically have loan origination fees, pay taxable interest at below market rates, and typically have maturity dates of up to 50 years. Loan origination fees are paid by the Licensee, and interest earned is deposited to the Licensee's obligation deposit account. Depending upon the terms, the Licensee receives the principal and interest earned periodically or at maturity of the CRDA bonds.

Licensees Subject to the CRDA

Licensees that elect to pay a percentage of their gross gaming revenues as a tax report the amounts paid to the CRDA as a gaming tax as the gaming revenues are earned.

Licensees that elect to invest in obligation deposits of the CRDA need to account for the multiple elements of the transaction, that is, a portion of the amount invested with the CRDA is effectively a gaming tax, and a portion is the fair value of the gaming entity's investment in the obligation deposit. Initially, obligation deposits are reported at fair value. Under the guidance of FASB ASC 820, the fair value of the initial obligation deposit assumes the highest and best use of the obligation deposit by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date.³ Generally, the fair value of the initial obligation deposit is less than its face amount because (1) its use is restricted to either purchase

² Casino Reinvestment Development Authority bonds are not backed by the full faith and guarantee of the state of New Jersey.

³ For additional guidance, refer to Financial Accounting Standards Board (FASB) *Accounting Standards Codification (ASC) 820-10-65-4*, as explained in FASB ASC 820, *Fair Value Measurements and Disclosures*.

CRDA bonds or make direct investments, and (2), as discussed previously, the interest rate on the obligation deposits is below market. For example, once the disposition of the obligation deposit is known, Licensees should account for the obligation deposit because it is ultimately used for CRDA bonds, direct investments to which the casino will have title, or direct investments to which the Licensee will not have title. The difference between the face amount of the initial obligation deposit and its fair value is reported as a gaming tax expense.

Interest income on obligation deposits invested in CRDA bonds will generally be recorded on an effective interest method, which records a constant interest rate over the life of the bonds based on the initial fair value of the bonds recorded and the discount rate applied to the future cash flows when acquired.

In circumstances in which the Licensee elects to use obligation deposits to purchase CRDA bonds, the investment in CRDA bonds is a special purpose restricted investment⁴ by the Licensee. Because the interest rate on the bonds is below market, the fair value of investments in CRDA bonds is generally less than the bond's face amount. Investments in CRDA bonds should be initially recognized at fair value. Interest received on CRDA bonds is generally recorded as interest income when earned and generally reported as an addition to the investments in CRDA bonds (discounted as discussed earlier). After the initial determination of fair value, the Licensee will generally analyze the recoverability of the bond and its effect on reported amounts based upon the ability and the likelihood of the CRDA to repay the bond. If indications exist that the value of the bond is further impaired, the asset will generally be adjusted in accordance with either FASB ASC 310 or FASB ASC 320,⁵ as appropriate.

In certain instances, the CRDA encourages and provides a Licensee an incentive to utilize their obligations for infrastructure investments for which the Licensee does not hold title, and a direct return will not be realized, nor will the funds ultimately be returned to the Licensee. These incentives generally take the form of a reduction in the investment that would otherwise be required by the Licensee. Generally, a cash flow incentive is provided to the Licensees. For instance, rather than making a 50-year investment at a below market rate, the Licensee gives up any future rights to some discounted amount of investment but receives credit as if they had invested the larger amount. Licensees will generally report as gaming tax expense the book value of obligation deposits used to make direct investments for which the Licensee does not retain title or expect return of the invested funds. For example, a licensee will generally report gaming tax expense for the amount of direct investments made to build an expressway exit to take customers to the Licensee's casino neighborhood in circumstances in which the Licensee does not retain title or control the use of the expressway exit.

Licensees will generally report as assets measured at fair value property acquired with obligation deposits for which the Licensee retains title, controls others' access, and obtains economic benefit. Licensees generally depreciate such assets over their estimated useful life.

In certain situations, a Licensee may commit to the use of CRDA funds for a specific project over a period of time. To the extent that the commitment

⁴ Subject to classification, the guidance in FASB ASC 310, *Receivables*, or FASB ASC 320, *Investments—Debt and Equity Securities*, will apply to the special purpose restricted investment.

⁵ For additional guidance, refer to FASB ASC 320-10-65-1.

pertains to existing investments in obligation deposits, the Licensee will apply the accounting discussed in the chapter on the date the commitment is made. To the extent that the commitment pertains to future investments in obligation deposits (that is, obligation deposits that have not yet come due because they pertain to amounts that will be owed by the Licensee to the CRDA based on future revenues), the Licensee will disclose the nature and amount of the commitment, if material. Licensees do not accrue any additional liabilities for such commitments because a liability does not exist unless and until the Licensee earns the revenue obligating it to pay the obligation deposit to the CRDA. In addition to any disclosures discussed previously, the notes to the financial statements generally will disclose the following pertaining to CRDA investments:

- The entity's accounting policy for CRDA investments
 - The amount of deposit obligations and bonds and the related discount
 - The disclosure requirements of FASB ASC 310-10-50 or FASB ASC 320-10-50
-

Appendix D

Currency Transaction Reporting in the Gaming Industry

Introduction

To assist the gaming industry and its auditors, this appendix provides some basic background information on money laundering related laws and regulations; reviews federal reporting requirements; describes several indicators of money laundering involving casinos; gives examples of certain warning signs that may help casinos protect themselves against money launderers and other criminals; and discusses obligations of auditors that may discover such activity.¹

The auditor performing an audit of a casino does not currently have any direct requirements to test or audit the casino's programs for detecting or preventing money laundering. Indirectly, the auditor is concerned over such compliance based on the auditor's overall concern regarding the entity's compliance with laws and regulations. Additionally the auditor would be concerned to assess the entity's liability for fines and other obligations that might result from such noncompliance. The auditor needs to consider the adequacy of disclosure and other reporting should the auditor discover that the entity is not or has not complied with its legal and regulatory requirements.

The auditor may choose to provide other services for a casino client to assist them with their anti-money laundering compliance program as discussed in subsequent paragraphs. In some cases, entities have chosen to outsource internal audit and other monitoring, compliance, and management functions to external CPA firms. CPA firms providing such services should consider and be mindful of the independence rules when providing multiple forms of services to a client.

Background on Money Laundering

Money is "laundered" to conceal illegal activity, including the crimes that generate the money itself, such as drug trafficking, so that the money can be used without detection of its criminal source. Financial institutions have been both witting and unwitting participants in laundering activities. Banks have been major targets in laundering operations because they provide a variety of services and instruments, including cashier's checks, traveler's checks, and wire transfers, which can be used to conceal the source of illicit proceeds. Criminals may also attempt to use casinos to hide or disguise the origin of funds derived from illegal activity because casinos provide similar types of services as those offered by banks as a normal part of casino operations, such as providing customer deposit or credit accounts, check cashing, currency exchanging, and transmitting and receiving funds transfers directly from other financial institutions. As a result of this risk, various laws enacted to prevent money

¹ Some of the information in this appendix was obtained from publications issued by the Financial Crimes Enforcement Network. See www.fincen.gov for publications, regulations, and other guidance regarding this topic.

laundering are applicable to casinos. In order to mitigate risk and to support national and international efforts against financial crime, it is important that casinos and auditors have a basic understanding of how money laundering schemes can operate. Many of the same controls used by casinos for purposes of protecting their assets and marketing to customers may be used to detect and prevent money laundering. Various requirements of federal regulations promulgated through the years have enhanced these internal controls.

Federal currency transaction regulations for casinos require monitoring of customer transactions using procedures that casinos routinely utilize in the normal course of their business. Casinos are always interested in knowing their customers in order to market to them for future visits and to provide complimentary commensurate with the policies of the casino for the level of play of the customer. They also attempt to monitor the customer's gambling activity, including the status of the customer's cash and credit play. For instance, a large credit player might visit the cage with the residual of the chips they obtained with a marker taken at a table game. Casinos prefer that patrons pay off marker debts rather than leaving with cash while the casino maintains a receivable. Similarly, if a customer made a deposit of cash with the casino against which the customer was to play by signing several markers at a table game against that cash deposit, the casino may segregate the specific currency deposited by the customer and return those bills when the customer deposit was refunded at the cage, rather than converting the deposit to different currency or into a financial instrument. These procedures are established by the casino to prevent activity that is not in their best interests. Although the gaming industry desires to accommodate the needs of their customers for purposes of gaming, they do not want to function as a bank for their customers, nor do the casinos want customers to use the casino cage for large currency exchanges or to use the gaming operation as a conduit for large wire transfers into and out of the casino with little or no gambling activity.

Money laundering can be a complex process. It involves three different, and sometimes overlapping, stages:

- *Placement* involves physically placing illegally obtained money into the financial system or the retail economy. Money is most vulnerable to detection and seizure during the placement stage.
- *Layering* involves separating the illegally obtained money from its criminal source by layering it through a series of financial transactions, which makes it difficult to trace the money back to its original source.
- *Integration* involves moving the proceeds into a seemingly legitimate form. Integration may include, for example, the purchase of automobiles, businesses, and real estate.

An important factor connecting the three stages of this process is the paper trail generated by financial transactions. Criminals try to avoid leaving this paper trail by attempting to circumvent reporting and recordkeeping requirements. Money launderers avoid reporting and recordkeeping requirements by "structuring" transactions, coercing or bribing employees not to file proper reports or complete required records, or by establishing apparently legitimate "front" businesses to open accounts or establish preferred customer relationships.

Bank Secrecy Act Regulations

In the United States, anti-money laundering legislation was first created in 1970 with the passage of the Bank Secrecy Act (BSA). This act required bankers to keep records and file reports about certain cash transactions. In 1985, the U.S. Department of the Treasury (Treasury) adopted regulations requiring the reporting of cash transactions by casinos. Congress passed the Money Laundering Control Act of 1986, which criminalized the act of money laundering. This was followed by the Annunzio-Wiley Anti-Money Laundering Act in 1992, and the Money Laundering Suppression Act of 1994, which added *casinos* to the definition of *financial institutions* in law (*Money and Finance, U.S. Code Title 31 Section 5312*). Following the terrorist attacks of September 11, 2001, the USA PATRIOT Act of 2001 (Patriot Act) substantially amended, and increased awareness of, the core BSA requirements and, once again, focused on the ability of financial institutions to combat money laundering and terrorist financing. As with many criminal activities, other legislation may be enacted in the future.

The Financial Crimes Enforcement Network (FinCEN), a bureau of the Treasury, administers and issues regulations pursuant to the BSA. The IRS serves as the examination authority of the BSA for all financial institutions not currently examined by a federal supervisory agency, including duly licensed or authorized casinos and card clubs. Through certain BSA reporting and record-keeping requirements, paper trails of transactions are created that law enforcement and others can use in criminal, tax, and regulatory investigations. The reporting and recordkeeping provisions of the BSA apply to banks, savings and loans, credit unions and other depository institutions (collectively referred to as *banks*), and to other businesses defined as financial institutions, including casinos, brokers and dealers in securities, and money services businesses (collectively referred to as *nonbanks*). Financial institutions are required by federal regulation to report both large currency transactions and suspicious monetary transactions. BSA regulations can be found in Title 31 U.S. *Code of Federal Regulations* (CFR) Parts 1000–1099.

Casinos and card clubs are typically considered financial institutions and subject to the requirements of the BSA when they are located in the United States and have gross annual gaming revenue in excess of \$1 million. Even when this gaming revenue threshold is not met, casinos and card clubs are required to report large inflows of currency into their trades or businesses.

Civil and Criminal Penalties

Civil and criminal penalties can be imposed for violations of anti-money laundering laws and regulations. Penalties can result in substantial fines and prison terms. For instance, the maximum criminal penalty for violating a BSA requirement is a fine of up to \$500,000 or a term of imprisonment of up to 10 years, or both. Therefore, it is important that casino employees are thoroughly trained on how to comply with BSA regulations, and that a system is in place to ensure that employees are following all anti-money laundering laws and regulations, including the timely filing of all required reports.

Summary of Selected BSA Regulations

The following summarizes some of the key provisions of the BSA regulations for casinos:

- *Suspicious Activity Report.* All casinos subject to the BSA regulations are required to file reports on suspicious activity involving \$5,000 or more in funds or other assets and must maintain a copy of all reports filed, as well as any supporting documentation for a period of 5 years from the date of the report. Upon request, casinos must make all supporting documentation available to FinCEN and any other appropriate law enforcement or supervisory agencies (including the IRS in its capacity as BSA examination authority).
- *Anti-Money Laundering (AML) Compliance Program.* All casinos are required to develop and implement an AML compliance program.
- *Currency Transaction Report.* Casinos must file reports on cash-in or cash-out transactions in currency involving more than \$10,000 conducted by, through, or to the casino on any one day by, or on behalf of, the same person.
- *Negotiable Instruments "Log."* Casinos must maintain a list of transactions (including a customer's name and address) involving various types of instruments, cashed or disbursed, in face amounts of \$3,000 or more, regardless of whether currency is involved.
- *Funds Transfer Rules.* Casinos must maintain certain information for funds transfers, such as sending or receiving a payment order for a funds transfer of \$3,000 or more, regardless of the method of payment. Casinos must retain records for all international wire transfers regardless of monetary value.
- *Record Retention.* All BSA records must be retained for a period of five years (including casino computer records, source documents, and related programs) and must be filed or stored in such a way so they are accessible within a reasonable period of time.

Suspicious Activity Reporting Requirements

Under BSA requirements, casinos are required to file a report of any suspicious transaction relevant to a possible violation of law or regulation. In addition, a casino may file a report of any suspicious transaction that it believes is relevant to the possible violation of any law or regulation, but whose reporting is not required by regulation. The transactions are reported on *Suspicious Activity Report by Casinos and Card Clubs* (SARC), FinCEN Form 102. Further, the CFR requires that a transaction requires reporting if it is conducted or attempted by, at, or through a casino and involves or aggregates at least \$5,000 in funds or other assets, and the casino knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part)

- involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity;

- is designed, whether through structuring or other means, to evade any requirements of the BSA or the BSA regulations;
- has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage; or
- involves use of the casino to facilitate criminal activity.

A casino should develop and implement a program to detect suspicious activity as a part of its overall AML compliance program. An effective program is one that is developed and implemented commensurate with the risks posed by the products and financial services provided by the casino and that is maintained and reasonably designed to prevent the casino from being used to facilitate money laundering or terrorist financing. Also, the AML compliance program requires the establishment of procedures for using all available information to determine the occurrence of any transactions or patterns of transactions required to be reported as suspicious. Each casino should apply the same risk-based analysis of its business model to create a process for detection, analysis, and reporting of potentially suspicious activity. If the casino determines that an activity is suspicious, it must file a SARC. After an investigation, the casino may determine that the activity is not suspicious. In that case, the casino should document the basis for its determination that the transaction is not, after all, suspicious.

SARC compliance examinations by the federal government will look at whether a casino's written program is designed to address the money laundering risks of the casino's particular business, whether the casino and its employees are following the program, whether employees are being properly trained, whether the program is being audited, results of these audits, and how the casino responds to the findings of compliance audits.

If a financial institution files a SARC with a government agency, the financial institution may not notify any person involved in the transaction that the transaction has been reported. Under certain circumstances, the casino is prohibited from complying with any subpoena or other request that is requesting disclosure of a SARC, and the casino and their employees are provided certain safe harbor protections from liability.

Auditors should take steps to ensure that they do not disclose SARCs or any related information filed by its client except when permitted by law.

If the casino has a separate state, local, or tribal suspicious activity reporting obligation, or an obligation to provide SARC information to state, local, or tribal regulators, the casino may provide the SARC, or the information contained therein, to those regulators pursuant to state law.

Suspicious Activity Examples

A casino is required to file a SARC if it "knows, suspects, or has reason to suspect" an activity or transaction is suspicious. It is not required to have proof of any illegality, nor is it required to form a legal opinion. It is the responsibility of the appropriate governmental agencies to analyze the SARCs received from all reporting financial institutions and to investigate possible violations of the law.

Potentially suspicious activities that require reporting may include the following:

- Structuring (see subsequent discussion)
- Terrorist financing (see subsequent discussion)
- Bribery, or attempt thereof, of casino employees
- Check and credit or debit card fraud
- Embezzlement or theft
- Misuse of position by a casino employee or knowingly assisting a patron in suspicious or prohibited activity
- Large currency exchanges, especially in which small denomination bills are exchanged for larger denomination bills (conversion may be attempted to reduce the quantity of bills in order to facilitate the transportation of illegally obtained currency)
- Large financial transactions by a casino patron in which the patron only conducted minimal gaming activity (patron may be attempting to create the appearance of gaming wins when no such gaming activity has occurred)
- Use of multiple credit or deposit accounts
- False or conflicting identification credentials
- No apparent business or lawful purpose
- Unusual use of counter checks or markers, personal checks, or wire transfers

The following are examples of some common suspicious activities:

- Unusual customer identification or information, including false identifications; two or more customers using similar identifications; altering transactions upon learning they must show identification; and altered spelling or order of the full name
- Transactions below relevant thresholds of \$10,000 for cash or \$3,000 for wire transactions
- Several transactions involving multiple persons working together to break one transaction into two or more transactions or using two or more locations or cashiers in the same day in order to break one transaction into smaller transactions and evade the BSA reporting or recordkeeping requirement

Structuring

Structuring is a violation of the BSA. It applies to conduct engaged in for the purpose of evading the thresholds for reporting or recordkeeping. If a casino observes a customer engaging in multiple cash transactions that are divided into amounts low enough to avoid the filing of a *Currency Transaction Report by Casinos* (CTRC) or other BSA recordkeeping requirements, but when added together would trigger one of these requirements, the customer may be "structuring" his or her transactions. Other examples include a customer with a \$100,000 marker debt, who repeatedly brings \$9,000 in cash to the casino over a number of days to make partial payments on the debt, or a group of persons each wires funds of \$2,990 from or to the same account.

Terrorist Financing

Terrorist financing does not necessarily involve criminal proceeds. It is the means by which terrorist groups transfer funds around the world. Examples may include customer requests for suspicious wire transfers into or from financial institutions in countries known as being friendly to terrorism, unfamiliar charities, use of multiple financial institutions, or requests for airplane tickets, jewelry, or other noncash gifts (easily converted to cash) to be given as a complimentary to a friend or to an unknown party.

Anti-Money Laundering Compliance Program Requirements

The Patriot Act and BSA regulations require casinos to establish an AML compliance program. Casinos are required to develop and implement a written program reasonably designed to assure and monitor compliance that includes a system of internal controls to assure ongoing compliance; internal or external independent testing, or both, for compliance; training of personnel; designation of an individual or individuals to assure day-to-day compliance; procedures for compliance with recordkeeping, retention, and reporting requirements; and use of data processing systems.

Currency Transaction Reporting Requirements

Casinos are required to report on a CTRC, FinCEN Form 103, for each transaction in currency involving cash-in and cash-out of more than \$10,000 in a gaming day. Cash-in and cash-out are to be aggregated separately, and multiple currency transactions shall be treated as a single transaction if the casino has knowledge that they are by, or on behalf of, any person and result in either cash-in or cash-out totaling more than \$10,000 during any gaming day.

Transactions in currency involving cash-in and cash-out include, but are not limited to, purchase or redemption of chips, tokens, and *plaques*²; front money or safekeeping deposits and withdrawals; payments or advances on any form of credit, bets, or exchanges of currency; currency given to a casino to purchase a casino check or to make a wire transfer for a customer; exchanges of currency (including foreign currency); payments on wagers; and check cashing or reimbursements for travel and other customer expenses.

CTRCs must be filed with the IRS within 15 calendar days following the day the reportable transaction occurs, and casinos must retain copies of all filed CTRCs for 5 years from the date of the report.

Documentation Requirements

Gaming operations are required to maintain and retain several types of source records, either originals or copies, such as the following:

- Records of each deposit of funds, account opened, or line of credit extended, including a customer's identification and the verification of that identification
- Records of each extension of credit in excess of \$2,500

² Terms that appear in the glossary are shown in *italics* the first time they appear.

Gaming

- Records of each advice, request, or instruction with respect to a transaction of any monetary value involving persons, accounts, or places outside the United States
 - Records prepared or used to monitor a customer's gaming activity (for example, player rating records, multiple transaction logs)
-

Appendix E

Rules of the Games

This appendix describes the rules of various games commonly found in a gaming entity. The descriptions are intended to be representative, but the rules, odds, and payoffs often differ depending on the particular gaming entity 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 subsequent diagram of the craps table layout for placement of various bets.

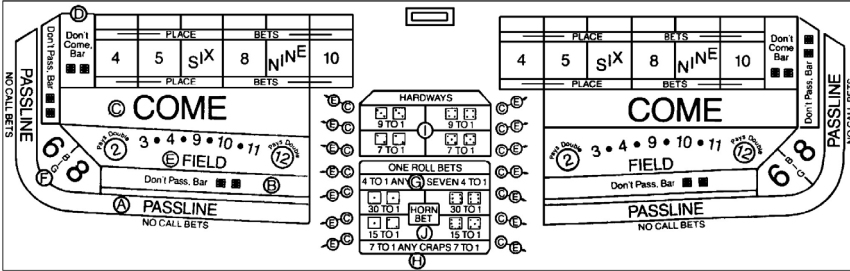
Pass Line (A). If a player places a bet on the Pass Line and the first roll of the dice (known as the *Come Out Roll*) is a 7 or an 11, he or she wins automatically. If a 2, 3, or 12 are rolled, he or she *craps out*, or loses. Any other number rolled (that is, 4, 5, 6, 8, 9, or 10) becomes the Pass 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 (in some casinos, a roll of a 2 is a standoff, and a 12 is an automatic win). 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 second point (if applicable) are independent of the original 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.



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.

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 in the subsequent table. 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 \$6 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 because 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 \$5 Horn High 12 has \$1 bet on 2, 3, and 11 and \$2 bet on 12. If one of these 4 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

	<u>Payout Odds</u>		<u>Payout Odds</u>
<i>Pass Line Bet</i>	1 to 1	<i>Don't Pass Line Bet</i>	1 to 1
<i>Come Bet</i>	1 to 1	<i>Don't Come Bet</i>	1 to 1
<i>Pass Line Odds, Come Bet Odds, and Buy Bets</i>		<i>Don't Pass Line Lay Odds, Don't Come Lay Odds, and Lay Bets</i>	
• 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 or 8	5 to 6
<i>Place Bet to Win</i>		<i>Big Six or Big Eight</i>	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		
		<i>Hardways</i>	
		• Hard 6 or Hard 8	9 to 1
		• Hard 4 or Hard 10	7 to 1

One Roll Bets

	<u>Payout Odds</u>
<i>Field Bets</i>	
• 3, 4, 9, 10, or 11	1 to 1
• 2 or 12	2 to 1
<i>Proposition Bets</i>	
• Any 7	4 to 1
• Any Craps	7 to 1
• 2 or 12	30 to 1
• 3 or 11	15 to 1
<i>Horn Bets</i>	
• 2 or 12	30 to 1
• 3 or 11	15 to 1
<i>Horn High Bets</i>	
• 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 (\$3 paid for each \$2 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, or each has a value of 10, 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 is 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.

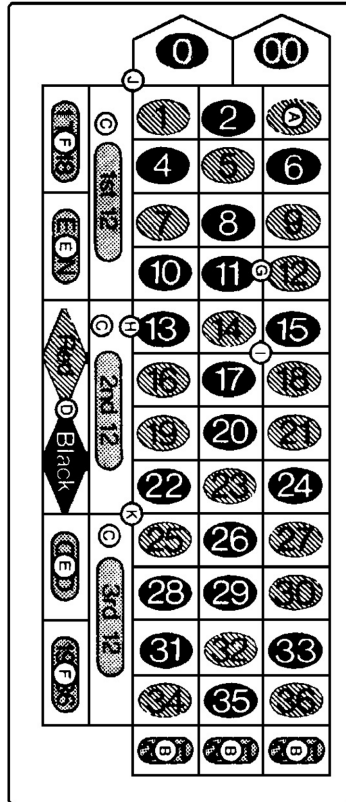
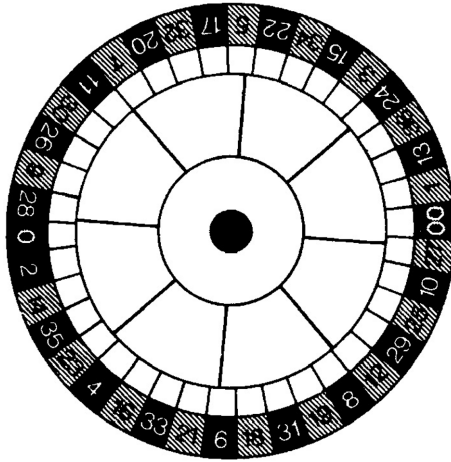
Insurance. If the dealer's up card is an ace, a player may elect to *take insurance* by placing, on the insurance line, a bet not greater than one-half of his original bet. The insurance bet is a wager that the dealer has blackjack. Insurance bets pay 2 to 1 if the dealer has blackjack, but they lose 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 1–36 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 1–18 or 19–36). 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.



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

<i>Example Position</i>	<i>Type of Bet</i>	<i>Pays Off if Ball Comes to Rest On</i>	<i>Odds</i>
A	Straight Up	The individual number bet, including 0 and 00	35 to 1
B	Column	Any of the 12 numbers in the column bet	2 to 1
C	Dozen	Any number in the range 1–12, 13–24, or 25–36, depending on which dozen is bet	2 to 1
D	Red or Black	Any number of the same color that was bet	1 to 1
E	Odd or Even	Any odd number for odd bet, even number for even bet	1 to 1
F	1–18 or 19–36	Any number in the range bet	1 to 1

Roulette Combination Bets

<i>Example Position</i>	<i>Type of Bet</i>	<i>Pays Off if Ball Comes to Rest On</i>	<i>Odds</i>
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 \$1 to \$20. 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 because there are less bills of the higher denomination. 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:

<u>A Bet On</u>	<u>Pays</u>
\$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, and 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:

<u>Having</u>	<u>Draws When Player's Third Card is</u>	<u>Does Not Draw When Player's Third Card is</u>
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 generally 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.

Let It Ride

Let It Ride is similar to poker, except the player is not playing against the dealer or the other players. The object of the game is to get the best poker hand possible by using their three cards and the dealer's two community cards.

Each player makes three bets of equal amounts and receives three cards. The dealer deals two "community cards" face down. Looking at the three dealt cards, the player can ask for one of their bets back or "let it ride." The dealer then turns the first "community" card over. The player can again ask for their second bet back or "let it ride." A player will always have at least one of their three bets at risk in each hand. The dealer turns over the last community card, and the winning hands are paid out.

The payout schedule may vary, but a sample is as follows:

<i>Hand</i>	<i>Payout</i>
Royal Flush	1,000 to 1
Straight Flush	200 to 1
Four of a Kind	50 to 1
Full House	11 to 1
Flush	8 to 1
Straight	5 to 1
Three of a Kind	3 to 1
Two Pair	2 to 1
Pair of 10s or better	1 to 1

Caribbean Stud

Caribbean Stud Poker is based on five-card stud poker. Each player antes with the option of playing for a progressive jackpot and receives five cards face down. The dealer gets five cards with one card face up. The players examine their hands and decide whether to make an additional bet, doubling their ante, or fold, losing their ante.

To qualify and continue playing, the dealer must have an Ace/King or better. If the dealer does not qualify, the player automatically wins the ante.

Winning hands are paid out with the following, representing a standard payout schedule:

<i>Hand</i>	<i>Payout</i>
Royal Flush	100 to 1
Straight Flush	50 to 1
Four of a Kind	20 to 1
Full House	7 to 1
Flush	5 to 1
Straight	4 to 1
Three of a Kind	3 to 1
Two Pair	2 to 1
Pair of 10s or better	1 to 1

If the player elects to play for the progressive jackpot, a \$1 gaming chip is placed into the acceptor box in front of them. The player qualifies for the jackpot if they have one of the five hands listed subsequently, regardless of what the dealer has. Payouts are fixed amounts for the lower hands and percentages of the progressive jackpot for the higher hands.

<i>Hand</i>	<i>Payout</i>
Royal Flush	100%
Straight Flush	10%
Four of a Kind	\$500
Full House	\$100
Flush	\$50

Three Card Poker

Three Card Poker is played similar to poker, except each player receives three cards. At the start of the game, each player makes two bets. Three cards are dealt to each player, and three cards are dealt to the dealer.

The first wager is called a "Pair Plus." The bet wins with a pair or better hand. Winning bets are paid by the following schedule:

<i>Hand</i>	<i>Payout</i>
Pair	1 to 1
Flush	3 to 1
Straight	6 to 1
Three of a Kind	30 to 1
Straight Flush	40 to 1

The second wager is called the *ante* and is used to play against the dealer. The object is to get a better hand than the dealer. To qualify, the dealer must have queen or better. After seeing his cards, the player can choose to play against the unknown dealer hand by making a "play" bet equal to the ante. If the dealer does not qualify, the player wins the ante only. If the dealer qualifies, the player has to beat the dealer to win the ante and the "play" bet. If the player has a better hand than the dealer, the player is paid even money and a bonus using the following schedule.

<i>Hand</i>	<i>Payout</i>
Straight	1 to 1
Three of a Kind	4 to 1
Straight Flush	5 to 1

Spanish 21

Spanish 21 is played like regular black jack, except using "Spanish" decks, which have no 10s or aces. The payouts are as follows:

<i>Hand</i>	<i>Payout</i>
Player's blackjack beats dealer's blackjack	3 to 2
Player's 21 beats dealer's 21	Up to 3 to 1
Double Down with two or more cards of any total	
Double Down Rescue—If the player isn't satisfied with his or her nonbusted hand, he or she may take back the doubled portion of the bet and forfeit the original wager.	
5 card 21	3 to 2
6 card 21	2 to 1
7+ card 21	3 to 1
6-7-8 mixed suits	3 to 2
6-7-8 suited	2 to 1
6-7-8 spaded	3 to 1
7-7-7 mixed suits	3 to 2
7-7-7 suited	2 to 1
7-7-7 spaded	3 to 1
7-7-7 suited and dealer's upcard is any 7	
\$5 to \$24 bet	\$1,000
\$25 bet	\$5,000

Casino War

The player makes an initial wager. One card is dealt to the player, and one card is dealt to the dealer. The highest card wins and is paid at 1 to 1. A tie wager is also an option and is paid at 10 to 1.

If the player's card is the same amount as the dealer's card, the player has the option to "war" with the "house." The player makes an additional wager equal to the original wager. Three cards are burned for both the player and the dealer, and one additional card is dealt. The highest card wins the "war." If the player wins the "war," he is only paid the amount equal to the original wager.

For example, assume the player makes an original bet of \$5 and ties the dealer. He then places another \$5 bet for a total of \$10. If the player wins the "war," he is only paid \$5.

Pai Gow Poker

Pai Gow Poker uses a standard deck of cards plus one joker. The joker is used only as an ace or to complete a straight, flush, or straight flush. The object of the game is to have both the high hand and the low hand be higher than the banker's hands (the banker is not necessarily the dealer). A banker is chosen by rolling a pair of dice and counting counterclockwise from the dealer. The banker is always a 1, 8, or 15. If the player refuses to be the banker, the banker will be played by the house. A player may become the banker if he has enough money to cover all bets on the table. A player may also elect to be a partial banker and only needs to be able to cover half of the total bets on the table.

To begin, dice are rolled to determine which player will receive the first set of cards. Each player receives seven cards and creates two hands, one with five cards, the high hand, and the other with two cards, the low hand. The dealer then sets the house's or banker's hand. Poker hand rankings are used to win. To win, both hands must be higher than the banker's respective hands. If both hands are lower than banker's hands, the player loses. If one hand is higher and one is lower than the banker's respective hands, the game is a "push," and no money changes hands. The only requirement to this game is that the low hand must only consist of two cards and must be lower than the high hand. The dealer handles all bets and retains a 5 percent commission on all winning bets.

The following are the Pai Gow Poker hand rankings:

- Five Aces (including joker)
- Royal Flush
- Straight Flush
- Four of a Kind
- Full House
- Flush
- Straight (A, 2, 3, 4, 5 is the second highest straight)
- Three of a Kind
- Two Pair
- Pair

Pai Gow Tiles

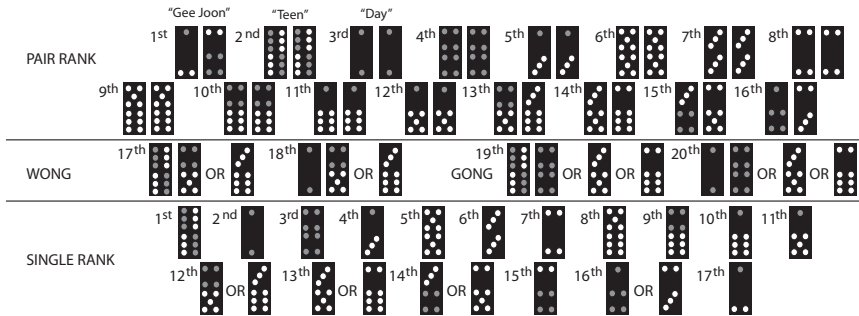
Pai Gow Tiles is an Asian game using dominoes, or tiles. The object of the game is to have both the high hand and the low hand be higher than the banker's hands (the banker is not necessarily the dealer). A banker is chosen by rolling a pair of dice and counting counterclockwise from the dealer. A player may

become the banker if he or she has enough money to cover all bets on the table. A player may also elect to be a partial banker and only needs to be able to cover half of the total bets on the table.

To begin, dice are rolled to determine which player will receive the first set of dominoes. The dominoes are placed in eight stacks of four and are positioned at every seat at the table, including the vacant seats, so that each player received four dominoes. To win, both hands must be higher than the banker's respective hands. If both hands are lower than banker's hands, the player loses. If one hand is higher and one is lower than the banker's respective hands, the game is a "push," and no money changes hands. If the player and the banker have two hands totaling the same number, the hand with the highest single domino wins. The banker wins all identical hands. Payoffs are even money. The dealer handles all bets and retains a 5 percent commission on all winning bets.

The highest hand is called a "Bo," or pair. However, a pair doesn't necessarily mean two identical dominoes. The next highest hand is called a "Wong," which is the 9 domino together with the 2 or 12 domino. The "Gong" is the next highest hand, which is the 8 domino together with the 2 or 12 domino. If none of these combinations can be made, the player must arrange the two dominoes to get as close to 9 as possible by summing them and using the last digit. For example, if the sum is 16, the 6 is counted. Two wild dominoes, the 3 and the 6, can be counted as either a 3 or a 6. Together, they make the highest hand, called the "Gee Joon."

The following chart shows the possible hands from highest to lowest:



Red Dog

Red Dog is a card game in which the player bets on the spread between two cards. To play, the player makes an initial wager, and the dealer deals two cards, face up. If the third card falls between the first two cards, the player wins. If it doesn't, the player loses. The player can also bet on the spread. This is called a "raise" bet. Opening bets are paid out at even money. Raise bets are paid out using the following schedule:

<i>Spread</i>	<i>Payout</i>
1	5 to 1
2	4 to 1
3	2 to 1
4-11	1 to 1

If the first two cards dealt are consecutive, the game is tied, and the player keeps his original bet. If the first two cards are the same, betting stops. If the third card makes it three of a kind, the player is paid at 11 to 1. If the third card does not make it three of a kind, the player loses.

Sic Bo

Sic Bo is a dice game with an Asian origin. Essentially, players can place multiple bets on various outcomes, totals, and combinations of rolling three dice. Payouts are listed as the following:

Sic Bo Payout Odds

<u>Wager</u>	<u>Payout Odds</u>	<u>Wager</u>	<u>Payout Odds</u>
Three of a kind	180 to 1	Total value of 11	6 to 1
Two of a kind	10 to 1	Total value of 12	6 to 1
Any three of a kind	30 to 1	Total value of 13	8 to 1
Total value of 4	60 to 1	Total value of 14	12 to 1
Total value of 5	30 to 1	Total value of 15	17 to 1
Total value of 6	17 to 1	Total value of 16	30 to 1
Total value of 7	12 to 1	Total value of 17	60 to 1
Total value of 8	8 to 1	Small bet	1 to 1
Total value of 9	6 to 1	Big bet	1 to 1
Total value of 10	6 to 1	One of a kind	1 to 1

Sic Bo Table

SMALL Are numbers 4 to 10 1 wins 1 Lose if any triple appears	Each double 1 wins 10			1 wins 180			1 wins 30			1 wins 180			Each double 1 wins 10			BIG Are numbers 11 to 17 1 wins 1 Lose if any triple appears
4	5	6	7	8	9	10	11	12	13	14	15	16	17			
1 wins 60	1 wins 30	1 wins 17	1 wins 12	1 wins 8	1 wins 6	1 wins 6	1 wins 6	1 wins 6	1 wins 8	1 wins 12	1 wins 17	1 wins 30	1 wins 60			
2 die 1 wins 5																
ONE	TWO		THREE			FOUR			FIVE			SIX				
1 to 1 on one die			2 to 1 on two die						3 to 1 on three die							

Keno

A keno ticket is numbered from 1–80. These numbers correspond to 80 numbered Ping-Pong-like balls contained in a special holding unit. The player marks from 1–20 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 keno 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 lit up on the boards. A keno payout schedule lists the number of matching numbers—catches—the player needs to make in order to win.

A keno game, in which the winning numbers are selected by a random number generator software program and not with rabbit ears, is called a *random number generator* game.

Race and Sports Books

Race Book

Betting in a race book can be conducted using the pari-mutuel method of wagering or the non-pari-mutuel method. Race books will have literature (house rules) to inform the patron of, among other things, the types of wagers that are accepted for each race at each track.

- *Pari-mutuel method.* Wagers in the race book are commingled with the pari-mutuel betting pools at the race track. The patron's wager affects the wagering odds at the track. Patron winning wagers are paid at full track odds by the race book acting as the track's agent. The race book has no risk of loss with pari-mutuel wagering. The book is guaranteed a percentage commission for each bet taken.
- *Non-pari-mutuel method.* Wagers are not commingled with the pari-mutuel betting pools at the race track. The race book is booking the patron's wager and risking its bankroll. The race book bases its payouts on the track's prices; therefore, the race book may set limits on payouts to protect themselves from very large winning tickets. Example: Assume a race book's house rules state that exacta payouts will be paid at a maximum of 250 to 1. If the patron placed a \$2 bet on an exacta in the race book and the payout at the race track was \$750, the book will only pay the patron \$502 due to the payout limit.

Types of Wagers

Various types of race book wagers exist, such as the following:

- *Win.* Horse must finish first to collect.
- *Place.* Horse must finish first or second to collect (if horse wins the race, patron receives place price not the win price).
- *Show.* Horse must finish first, second, or third to collect (if horse comes in first or second, patron receives the show price not the win or place price).

- *Daily Double*. Winning horses must be selected in two consecutive races to collect.
- *Exacta and Perfecta*. The first two finishing horses in the exact order must be selected to collect.
- *Quinella*. The first two finishing horses in either order must be selected to collect.
- *Trifecta*. The first three finishing horses in the exact order must be selected to collect.
- *Superfecta*. The first four finishing horses in the exact order must be selected to collect.
- *Pick Three, Pick Four, and so forth*. To win a Pick Three wager, the winners of three consecutive races must be selected. The track will designate which races will be subject to Pick Three wagering. The same basic principle applies to Pick Four wagering, Pick Five, and so forth.
- *Parlay*. Series of two or more selections in separate races in which the wager on the first race plus its winnings are then risked on each of the remaining, selected races. (The win amount of the first horse bet becomes the wager on the second horse bet and so on.) The patron can choose from any race and any track, as well as a combination of win, place, or show wagers. If one horse in the parlay fails to finish as high as wagered, the entire wager is considered a loser. In the event a horse is scratched (does not run), a three-horse parlay is reduced to a two-horse parlay, and a two-horse parlay becomes a straight bet.
- *Future book wager*. Wagers taken on major horse racing events, such as the Kentucky Derby and Breeder's Cup Classic prior to the day of the race. For these types of wagers, the patron receives fixed wagering odds at the time the wager is made and if the horse does not run the race, the patron's wager is considered a losing wager rather than a refund.
- *Horse match up wager*. Wager that matches one horse against another in a race, and the winner is determined by which horse finishes ahead of the other.

Sports Book

Wagers in the sports book can be made on various types of sporting events. The following are some different types of wagers on the most common types of sporting events.

Football

Various types of wagering in football exist, such as the following:

- *"Point line" wager*. A wager on the winner of a football game in which one team is giving another team a certain amount of points in an attempt to equalize the two teams. Example: Steelers are the favorite at -7 points against the underdog Browns at $+7$ points. If the patron places a wager on the Steelers, the Steelers would have to win the game by more than 7 points in order for the patron

to win the bet. If the patron places a wager on the Browns, the Browns would have to either win the game or else lose by less than 7 points in order for the patron to win the bet. Should the Steelers win by exactly 7 points, the game would be classified as a tie, and all wagers on both teams would be refunded. Generally, for all point line wagers, the wager to pay-off ratio is 11 to 10. For example, a winning \$110 wager will pay \$100 plus the original wager, for a total of \$210.

- *"Total" wager.* A wager in which the patron will bet that the total combined final score of both teams will either be over or under a number determined by the sports book. Example: The over and under total of the Steelers/Browns game is set at 47. Assume the final score of the game is Steelers, 23 and the Browns, 10. The total combined score for both teams is 33. Patrons wagering on the under would win their bet, whereas those betting on the over would lose. Should the total points scored fall exactly on 47 points, the wager would be classified as a tie, and all wagers on both the over and the under would be refunded. Generally, winning "total" wagers will be paid with a wager to pay-off ratio of 11 to 10.
- *"Money line" wager.* A wager on the winner of a football game when no point spread is used for either team; however, there are betting odds assigned to both teams. Example: The favored Steelers are -200 betting odds to win against the underdog Browns, who are listed as +180. If the patron bet the Steelers to win the game, he would wager \$200 to win \$100, for a total of \$300. If the patron bet the Browns to win the game, he would wager \$100 to win \$180, for a total of \$280.)
- *Parlay wager.* A wager in which the patron combines two or more point line wagers, total wagers, or money line wagers in a single wager. All included wagers in the parlay must win in order for the patron to collect. In the event of a tie or cancellation of any game or total, the parlay is reduced to the next betting bracket (for example, a three-team parlay is reduced to a two-team parlay, a two-team parlay becomes a straight bet). Different sports books have different standard payouts for their different parlay offerings. Example: Sports book parlay payout odds for two-team/total parlay is listed as 13 to 5. A patron wagers a \$10 parlay wager on Steelers -7 and under 47 in the Steelers/Browns game. If the Steelers win the game 23 to 10, the patron wins \$26, and the patron would receive a total of \$36 (\$26 for the win and \$10 return of his bet).
- *Teaser wager.* A wager that allows the patron to adjust the listed point spread by 6, 6.5, or 7 points. The patron must choose between 2 or more teams. All teams selected in a teaser combination must win by a margin as adjusted by the teaser point spread. In the event of a tie or cancellation of any game, the teaser is reduced to the next betting bracket (for example, a 3-team teaser is reduced to a 2-team teaser, a 2-team teaser involving a tie wager is considered no action, and money is refunded.) Example: A patron wagers a \$12 two-team, 6-point teaser on the favorite Steelers at -1 (actual point spread -7) in game #1 and the underdog Broncos

at +13 (actual point spread +7) in game #2. If both the Steelers and Broncos win their games by 3 points, the patron wins his bet and wins \$10 for a total payoff of \$22 (assuming the book uses a 12/10 payoff ratio for teaser bets).

Basketball

Various types of wagering in basketball exist, such as the following:

- *Point line wager.* See football point line wager.
- *Total wager.* See football total wager.
- *Money line wager.* See football money line wager.
- *Parlay wager.* See football parlay wager. Sports books may have different standard parlay pay-off prices for basketball and football.
- *Teaser wager.* See football teaser wager. In basketball, the teaser point spread may be adjusted by four points.

Baseball

Various types of wagering in baseball exist, such as the following:

- *Money line wager.* See football money line wager. In addition to betting on a team to win a baseball game, the patron may condition his bet on a specific pitcher winning the game (listed pitcher). If a patron lists a pitcher and that pitcher does not start the game, the patron will be refunded his wager. The following are a list of baseball money line wagers:
 - Team vs. team
 - Listed pitcher vs. listed pitcher (that is, both pitchers must start)
 - Team vs. listed pitcher (that is, listed pitcher from specified team must start against any pitcher from the other team)
- *Total wager.* See football total wager. In order to have a live wager, both listed starting pitchers must start the game, and the game must go at least 9 innings or 8 1/2 innings with the home team winning, otherwise the wager will be considered no action.
- *Parlay wager.* See football money line parlay wager.
- *Run line wager.* See football point line wager; however, wagering odds may not be \$11 to win \$10. Each sports book will have its own wagering odds posted for this type of wager. In addition, in order to have a live wager, both listed starting pitchers must start the game, and the game must go at least 9 innings or 8 1/2 innings with the home team winning, otherwise the wager will be considered no action.

Hockey

Various types of wagering in hockey exist, such as the following:

- *Money line wager.* See football money line wager.
- *Total wager.* See football total wager.

- *Parlay wager.* See football money line parlay wager.
- *Goal line wager.* See football point line wager; however, wagering odds may not be \$11 to win \$10. Each sports book will have its own wagering odds posted for this type of wager.

A *parlay card wager* is a wager in which a patron can select three or more point line or total type wagers off a standardized card issued by the sports book. The point line spreads and total wager numbers do not change once the card is printed and released to the public. The cards are issued by the sports book either on a daily or weekly basis, with the payout schedule and rules listed on the back of the card.

A *future book wager* is a wager taken on sporting event championships, such as the Super Bowl, World Series, NBA Championship, Stanley Cup, and other major sporting events prior to the day of the race. Sports books will create betting odds for the winner of these events.

A *proposition wager* is a wager that is created to entice additional wagering on a sporting event. Example: In the Super Bowl, a wager can be made on which team will win the coin flip. These wagers can be set up as a point line wager, total wager, or money line wager.

Sports books will also provide wagering on other sporting events such as golf, NASCAR, and soccer, for example, utilizing the different types of wagers previously described.

Poker

Numerous variations of poker exist, with several common games described in the following text. Poker is unique among casino games in that the customer is wagering against other customers instead of the house. The gaming entity makes money by taking a percentage of each game's wagers, known as the *rake* (which may also be charged based on time). For poker tournaments, the casino charges an entry fee above and beyond the amount added to the prize pool.

Winning poker hands are as follows, in order of superiority:

- Royal Flush—A, K, Q, J, 10 in the same suit
- Straight Flush—any straight in the same suit
- Four of a Kind—four cards of the same number (4, 4, 4, 4)
- Full House—three cards of one number and two of another (7, 7, 7, 2, 2)
- Flush—5 cards of the same suit
- Straight—5 consecutive cards of mixed suits
- Three of a Kind—three cards of the same number (K, K, K)
- Two pair—two pairs of cards with the same numbers (2, 2, 3, 3)
- Pair—one pair of cards of the same number (3, 3)

General Poker Terms

The following are some commonly used general poker terms:

- *Ante*. Initial bet before any cards have been dealt.
- *Bad beat pot*. A progressive payout in poker or other card games, which is awarded when a patron holding a specified minimum hand loses to another patron with a higher hand.
- *Check*. Pass on a bet if no one else has placed a bet.
- *Fold*. To quit the current game and discard all of one's cards.
- *Open*. The first bet after the first hand has been dealt.
- *Raise*. To increase a bet, a player must "see" a bet before he can raise it.
- *See*. To match a bet.

Five Card Draw

To begin the game, each player places an ante bet. The dealer deals each player five cards, face down. After looking at their cards, the players may make additional bets based on what they have or may fold. Then, each player will choose to either keep the cards that he has or to discard ones that he can't use. A player can discard up to three cards, and all discarded cards are placed face down on the table. The dealer deals 0–3 new cards to each player, and the players bet again based on what they have. Once the betting has stopped, each player shows his cards, and the winner takes the pot.

Texas Hold'em

In Texas Hold'em, each player is trying to make the best poker hand possible using a combination of his two cards and five community cards. The betting amounts are fixed at a limit (unless being played in a "no-limit" format). All bets and raises during the first two betting rounds are fixed to a minimum bet. All bets and raises during the last two betting rounds are fixed at the maximum bet. These limits are set by each individual house.

Play starts to the left of the "dealer" (the dealer position rotates around the table after each hand), with two forced bets, the *small blind* (usually half of the low limit bet) and the *big blind* (usually the amount of the low limit bet). Then, the first two cards for each player are dealt face down, and the first round of betting begins. Each player will either "see" or "raise" the low limit bet or will "fold."

Next, three "community" cards (the flop) are dealt face up on the table, and another round of betting takes place. A fourth "community" card (the turn card) is dealt face up, followed by another round of betting. Finally, a fifth "community card" (the river card) is dealt face up with the final round of betting. Using any combination of the player's two cards and the five community cards, each player makes the best five-card hand possible.

7 Card Stud Poker

In 7 Card Stud, each player receives seven cards and tries to make the highest poker hand possible (using 5 cards). Betting limits are fixed to a low and high

amount (unless being played in a "no-limit" format). To begin, each player puts in an *ante* (amount determined by the house), and is dealt two cards face down and one card face up. The lowest card makes the first bet equal to the low limit, and each player will either check, see, raise, or fold. All raises are made at the low limit.

The fourth card is dealt face up to each player, and the highest hand showing will have the opportunity to place the first bet. Once again, all raises are fixed at the low limit.

The fifth and sixth cards are dealt face up, each with its own round of betting, starting with the highest hand showing. These bets are made at the high limit, and raises are fixed at the high limit.

The final card is dealt face down to each player, and the final round of betting is made at the high limit. Once all betting has stopped, those still in the game will show their hands, and the highest hand wins the pot.

Bingo

To play bingo, a player will purchase a card with a 5x5 grid and the letters B-I-N-G-O on the respective columns. Each card in a series is individually numbered. Each box has a number, except for the middle box, which is a free space. The numbers assigned to each row are as follows:

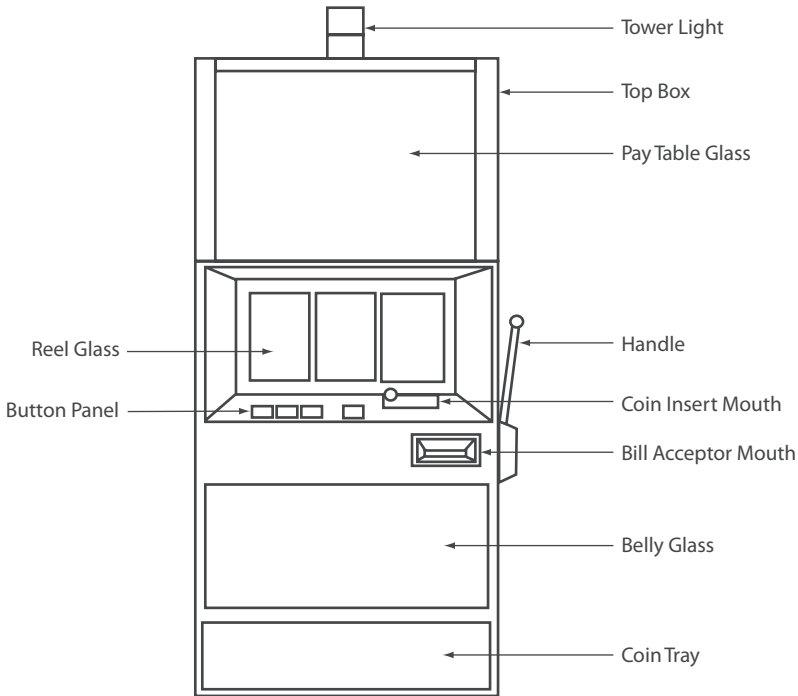
B	-	1-15
I	-	16-30
N	-	31-45
G	-	46-60
O	-	61-75

B I N G O				
14	25	34	52	68
1	24	38	51	69
4	26	Free	48	74
3	23	41	46	63
6	20	39	56	70

Numbers, such as B-2 and I-24, are chosen at random until a player has filled a line with five numbers either horizontally, vertically, or diagonally. The first player to fill a line with five numbers wins the game and the established winning prize. Variations exist whereby different winning patterns or designs are established (that is, achieve the letter "M," "cover all," fill two lines with 5 numbers, and so forth). The first player to achieve the desired pattern or design wins the established prize.

Slot Machines

The following diagram is a depiction of a typical slot machine:



Kinds of Slot Machines

The three most common kinds of spinning reel slot machines are mechanical, electronic stepper, and electronic video.

Mechanical machines operate independently on a stand-alone basis. They typically are controlled by a motion of *reels*¹ and have predetermined prize amounts that are unaffected by the level of play. Mechanical machines tend to be more susceptible to manipulation by use of gadgets and other nonsophisticated, homemade instrumentation than are machines utilizing modern technology. Accordingly, mechanical machines are more susceptible to patron cheating than are machines utilizing modern technology.

Electronic stepper machines are controlled by a central computer (or an internal computer) and use random number generators and other control programs to determine which *symbols* appear in the reel glass on the *payline*.

Electronic video machines operate the same as electronic stepper machines, except that electronic video machines display symbols using a video monitor rather than through spinning reels. These machines, at times, will offer games that simulate 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.

¹ Terms that appear in the glossary are shown in *italics* the first time they appear.

The Inner Workings of an Electronic Slot Machine

Functionally, electronic slot machines operate as follows:²

1. The player pulls the handle (or taps the "spin" button on the button panel).
2. The computer generates a set of numbers, which correspond to the number of reels, from the random number generator.
3. The computer divides the first number by a predetermined number of positions (referred to as *stops*) on a virtual reel.
4. The remainder then corresponds to a specific stop on the virtual reel.
5. Each stop on the virtual reel corresponds to a stop on the physical reel.
6. The computer moves the physical reel to the appropriate stop, thus, signaling to the player the result of that particular spin.

Slot machines are available in a variety of models and denominations. One or more monetary credits³ may be played at a given time, depending upon the model of slot machine the player chooses. The player begins by wagering one or more monetary credits, which allows the handle to be pulled (or the button to be pressed, which simulates a handle pull). The pull of the handle starts a series of reels spinning. Each reel has a number of symbols or numbers on it. The appearance of certain symbols, the number of symbols, the combination of symbols, and the sequence of symbols determine whether various jackpots are won (*hit*). Different machines may have different winning combinations, with the winning combinations and resulting jackpots depicted on visual displays on each machine. The frequency of jackpot payouts is random, but over the long run, predetermined by the theoretical *payout percentage* programmed into the machine.

In multiple credit machines, additional monetary credits provide more opportunities to win or larger payouts with each handle pull. For example, each additional credit may provide an additional line of symbols to match up a winning combination, "buy" additional symbol combinations, or increase the payout for each combination.

Some winning combinations are paid automatically by the machine, whereas others (larger dollar amounts) require a slot attendant to pay off the jackpot. A light on top of the machines (referred to as a *candle* or *tower light*) signals a slot attendant when his or her assistance is necessary for a payout. Additional credits cannot be played until the machine or the slot attendant has completed the payout.

Determining Jackpots

A *nonprogressive jackpot* is a jackpot that is limited to a given machine and is independent of other machines on the casino floor. A nonprogressive jackpot pays out a fixed amount that is predetermined and is depicted on the pay table

² This description is in the context of electronic machines. Mechanical slot machines rarely exist in today's environment. The accounting for jackpots is unaffected by whether the machine is mechanical or electronic.

³ Monetary credits may be played by using bills, coins, tickets, electronic wagering credits recorded on cards, or by other means.

on the machine. Increasing the number of credits played typically increases the amount of the jackpot.

A progressive jackpot is a type of jackpot that grows each time a player bets. There are local area progressive and wide area progressive (WAP) jackpots. A local area progressive jackpot is a jackpot that is generated from a group of machines that are operated at a single location and connected by a linked network. The jackpot grows based on the play on those connected machines. A WAP jackpot is a jackpot generated from a group of machines that are operated at multiple locations and connected by a linked network. WAPs provide casino operators with the opportunity to offer patrons jackpots that typically are larger than jackpots paid on stand-alone machines and local area progressive jackpots.

The progressive jackpot amount starts at a specific base amount (*base progressive jackpot*) and grows "progressively" based on monetary credits played (*incremental progressive amount*). A portion of the monetary credits played through each machine in the network is added to the progressive jackpot. The progressive jackpot amount is displayed on meters on all machines in the network and increments until a patron wins the progressive jackpot amount, at which time the progressive jackpot amount is reset to the base and the process repeats.

The largest WAP jackpots typically are administered by entities independent of the gaming entities operators. Casino operators typically remit to the WAP administrator a percentage of the monetary credits played on the individual casino's machines for services related to maintaining and administrating the WAP system, including the payment of winners over an extended period of time after the jackpot win.

The payout percentage of a machine indicates what percentage of the money played through it will be returned to the players in the long run. For every slot machine except WAP, the casino is able to choose from the payout percentages that are preset by the manufacturer and typically range from one to five pay tables. The payout percentages must be above the legal minimum set by the governing jurisdiction. Not all slot machines on the floor are homogenous. Payout percentages vary from casino to casino and even from machine to machine within a particular casino. Payout percentages from casino to casino can vary widely. Casinos determine the mix of slot machines placed on their floor and payout percentages with an aim toward inducing the amount of volume and payouts that will result in the highest win. For example, an individual slot machine may have a payout percentage as high as 98 percent, and the slot machine next to it may have a payout percentage of 93 percent (assuming these two percentages are above the legal minimum set by the jurisdiction). A payout percentage of 98 percent does not mean that for every \$100 of coin-in, the machine will payout exactly \$98. In some jurisdictions, payout percentages on an aggregate basis are published for the customer to see.

Because the result of each spin is chosen at random, only over time will a machine's actual performance achieve the designed payout percentage. Some deviation from the machine's payout percentage is allowed and expected, but the deviation gets smaller as the number of spins played on a machine increases.

The following table shows the deviations expected. The expected deviation column is a range because each slot machine differs.

<i>Number of Spins</i>	<i>Expected Deviation</i>
1,000	30–45%
10,000	10–15%
100,000	3–5%
1,000,000	1–1.5%
10,000,000	0.3–0.5%

The expected deviation represents the amount by which the actual payout percentage on a slot machine will differ from its theoretical payout percentage after 10,000,000 spins, within a certain confidence level. Normally, the industry standard assumes a 90 percent confidence level; however, this percent could vary based on jurisdiction. For example, assuming 1,000 spins and a theoretical payout percentage of 90 percent, the actual payout could be between 45 percent and 135 percent (assuming the high end of the expected deviation in the preceding table). For 10,000,000 spins, the actual payout percentage could be between 89.5 percent and 90.5 percent. Because every combination is random, there are no absolute guarantees of exact payout percentages.

Server Based Gaming

The previous description of slot machine operations addresses conventional slot machines that operate independently from other machines in the casino. Each machine determines the outcome of a wager using control programs contained on *erasable programmable read-only memory* installed in a secure manner within the device. Advances in server based gaming technology allow the slot machine to be interfaced with a system whereby the control programs within the slot machine can be modified to change the types of games being offered, denomination of the machines, and game themes. A slot machine that can be modified in this fashion is commonly known as a *system supported game*.

Another type of server based gaming technology allows the control programs to be stored on the computer system itself. When a wager is made, the determination of win or loss is made by the system with the outcome displayed on the slot machine. When configured in this manner, the slot machine simply becomes a display device with a ticket printer, currency acceptor drop box, and *bill validator*. Such system and display devices are collectively referred to as a *system based game*.

Although more sophisticated control programs, systems, and communication networks are required with server based gaming, the basic gaming revenue model for slot machine operations is still applicable.

Lotteries

State lotteries operate one or more of the following forms of lottery gaming:

- Lotto
- Instant games
- Video lottery terminals

Lotto tickets are sold by an agent with ticket issuance or validation terminals, which are interfaced with the lottery's central computer via communication lines. Lotto tickets cost \$1 per play in most cases. A ticket can be purchased for several different types of games. Super lotto type games typically require the patron to select 6 numbers, and these drawings are held twice a week. The prize pools are typically pari-mutuel in nature, with the maximum prize increasing with every ticket sold. *Daily game* tickets can also be purchased, in which 3, 4, or 5 numbers must be selected, and the drawings take place once a day. *Keno lottery* tickets can also be purchased, and these games may be conducted as often as every 4–5 minutes. Super lotto ball drawing procedures are somewhat similar to procedures employed in a casino keno game in that balls are selected from a ball drawing device. The number of balls in the device varies depending on the game and state regulations. The drawing is performed in a public venue and is typically televised, and many times, will be monitored by an independent accountant. Many times, smaller payout games will use a computerized automated drawing device containing a random number generator. Winning tickets are validated by the agent, and the agent will make the smaller payments usually in amounts less than \$600. Larger winning tickets are paid by the central lottery office. Most states allow the winner of multi-million dollar prizes to receive annuity payments over 20–25 years or receive an immediate cash option whereby the future annual payments are discounted using prevailing interest rates.

Lotteries create different types of instant game themes, and thousands of preprinted tickets are distributed to agents throughout the state. Based on instructions from the lottery, a certain number of tickets are printed by ticket manufacturers with varying payout amounts, with the balance being losing tickets. The tickets are numerically controlled and contain a hidden validation number. Cost of the tickets vary with the game played and may range from \$1–\$5. Patrons purchase instant tickets from the agents and scratch off the covering to determine whether the ticket is a winner. Winning tickets are paid after validation, with the larger winners also paid by the central lottery office.

Some states allow the operation of video lottery terminals, or VLTs. A VLT is similar in appearance to a slot machine, and each VLT typically will individually determine gambling wins or losses. VLTs accept currency or coins and normally do not pay out wins in coins—a ticket is printed, which is redeemed by the agent operating the devices. VLTs are required to be connected to the lottery's centralized computer system, which is used to communicate auditing information from the VLTs such as wagers, payouts on winning wagers, and credits cashed to tickets. The lottery can also activate and deactivate VLTs from their offices.

Appendix F

International Financial Reporting Standards

Note: The following content may include certain changes made since the original print version of the guide.

Introduction

The following information provides a brief overview of the ongoing globalization of accounting standards, International Financial Reporting Standards (IFRSs) as a body of accounting literature, the status of convergence with IFRSs in the United States, and the related issues that accounting professionals need to consider today.

Globalization of Accounting Standards

As the business world becomes more globally connected, regulators, investors, audit firms, and public and private companies of all sizes are expressing an increased interest in having common accounting standards among participants in capital markets and trading partners around the world. Proponents of convergence with, or adoption of, IFRSs for financial reporting in the United States believe that one set of financial reporting standards would improve the quality and comparability of investor information and promote fair, orderly, and efficient markets.

Many critics, however, believe that U.S. generally accepted accounting principles (GAAP) are the superior standards and question whether the use of IFRSs will result in more useful financial statements in the long term and whether the cost of implementing IFRSs will outweigh the benefits. Implementing IFRSs will require a staggering effort by management, auditors, and financial statement users, not to mention educators.

The increasing acceptance of IFRSs, both in the United States and around the world, means that now is the time to become knowledgeable about these changes. The discussion that follows explains the underpinnings of the international support for a common set of high quality global standards and many of the challenges and potential opportunities associated with such a fundamental shift in financial accounting and reporting.

The international standard setting process began several decades ago as an effort by industrialized nations to create standards that could be used by developing and smaller nations. However, as cross-border transactions and globalization increased, other nations began to take interest, and the global reach of IFRSs expanded. More than 100 nations and reporting jurisdictions permit or require IFRSs for domestic listed companies (and most have fully conformed to IFRSs as promulgated by the International Accounting Standards Board [IASB] and include a statement acknowledging such conformity in audit reports). Several countries are expected to transition to IFRSs by, or beginning

in, 2011, and many other countries have plans to converge (or eliminate significant differences between) their national standards and IFRSs.

For many years, the United States has been a strong leader in international efforts to develop globally accepted standards. Among other actions in support of IFRSs, the U.S. Securities and Exchange Commission (SEC) removed the requirement for foreign private issuers registered in the United States to reconcile their financial reports with U.S. GAAP if their accounts complied with IFRSs as issued by the IASB. In addition, the SEC continues to analyze and evaluate appropriate steps toward, and challenges related to, converging U.S. GAAP with IFRSs, as subsequently described.

In addition to the support received from certain U.S. based entities, financial and economic leaders from various organizations have announced their support for global accounting standards. Most notably, in 2009, the Group of Twenty Finance Ministers and Central Bank Governors (G20), a group from 20 of the world's systematically important industrialized and developing economies (with the 20th member being the European Union, collectively), called for standard setters to redouble their efforts to complete convergence in global accounting standards.

Acceptance of a single set of high quality accounting standards may present many significant opportunities, including the improvement in financial reporting to global investors, the facilitation of cross-border investments, and the integration of capital markets. Further, U.S. entities with international operations could realize significant cost savings from the use of a single set of financial reporting standards. For example, U.S. issuers raising capital outside the United States are required to comply with the domestic reporting standards of the foreign country and U.S. GAAP. As a result, additional costs arise from the duplication and translation of financial reporting information.

Many multinational companies support the use of common accounting standards to increase comparability of financial results among reporting entities from different countries. They believe common standards will help investors better understand the entities' business activities and financial position. Large public companies with subsidiaries in multiple jurisdictions would be able to use one accounting language company-wide and present their financial statements in the same language as their competitors. In addition, some believe that in a truly global economy, financial professionals, including CPAs, will be more mobile, and companies will more easily be able to respond to the human capital needs of their subsidiaries around the world.

Although certain cost reductions are expected, the initial cost of convergence with IFRSs is expected to be one of the largest obstacles for many entities, including accounting firms and educational institutions. Substantial internal costs for U.S. corporations in the areas of employee training, IT conversions, and general ledger software have been predicted. In addition, the time and effort required from various external functions, including the education of auditors, investors, lenders, and other financial statement users, will be significant factors for consideration.

Although the likelihood of acceptance of IFRSs may lack clarity for the time being, U.S. companies should consider preparing for the costly transition to new or converged standards, which likely will include higher costs in the areas of training and software compliance.

Who is the IASB?

The IASB is the independent standard setting body of the IFRS Foundation, formerly, the International Accounting Standards Committee Foundation. As a private sector organization, the IFRS Foundation has no authority to impose funding regimes on countries. However, a levy system and national contributions through regulatory and standard-setting authorities or stock exchanges have been introduced in a number of countries to fund the organization. Although the AICPA was a founding member of the International Accounting Standards Committee (IASC), the IASB's predecessor organization, it is not affiliated with the IASB.

The IASB, founded on April 1, 2001, in London, England, is responsible for developing IFRSs and promoting the use and application of these standards. In pursuit of this objective, the IASB cooperates with national accounting standard setters to achieve convergence in accounting standards around the world.

The structure includes the following primary groups: (a) the IFRS Foundation, an independent organization having two main bodies: the IFRS Foundation trustees and the IASB; (b) the IFRS Advisory Council; and (c) the IFRS Interpretations Committee, formerly the International Financial Reporting Interpretations Committee (IFRIC). The trustees appoint the IASB members, exercise oversight, and raise the funds needed, but the IASB itself has responsibility for establishing IFRSs.

The IASB board members are selected chiefly upon their professional competence and practical experience. The trustees are required to select members so that the IASB will comprise the best available combination of technical expertise and international business and market experience and to ensure that the IASB is not dominated by any particular geographical interest or constituency. The IASB has members from several different countries, including the United States. The members are responsible for the development and publication of IFRSs, including *International Financial Reporting Standard for Small- and Medium-sized Entities (IFRS for SMEs)*, and for approving the interpretations of IFRSs as developed by the IFRS Interpretations Committee.

The IFRS Interpretations Committee, founded in March 2002, is the successor of the previous interpretations committee, the Standing Interpretations Committee (SIC), and is the interpretative body of the IASB. The role of the IFRS Interpretations Committee is to provide timely guidance on newly identified financial reporting issues not specifically addressed in IFRSs or issues in which interpretations are not sufficient.

IFRSs are developed through a formal system of due process and broad international consultation, similar to the development of U.S. GAAP.

Readers are encouraged to become involved in the standard-setting process by responding to open calls from the standard setting organizations.

What Are IFRSs?

The term *IFRSs* has both a narrow and broad meaning. Narrowly, IFRSs refers to the numbered series of pronouncements issued by the IASB, collectively called *standards*. More broadly, however, IFRSs refer to the entire body of authoritative IASB literature, including the following:

- Standards, whether labeled IFRSs or International Accounting Standards (IASs)¹
- Interpretations, whether labeled IFRIC (the former name of the interpretive body) or SIC (the predecessor to IFRIC)²

The preface to the IFRS *2010 Bound Volume* states that IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities, including commercial, industrial, and financial entities, regardless of legal form or organization. IFRSs are not designed to apply to not-for-profit entities or those in the public sector,³ but these entities may find IFRSs appropriate in accounting for their activities.

The IASB's *Framework for the Preparation and Presentation of Financial Statements* (IASB Framework) establishes the concepts that underlie the preparation and presentation of financial statements for external users. The IFRS Foundation is guided by the IASB Framework in the development of future standards and in its review of existing standards. The IASB Framework is not an IFRS, and when there is a conflict between the IASB Framework and any IFRS, the standard will prevail. The IASB Framework is an overall statement of guidance for those interpreting financial statements, whereas IFRSs are issue and subject specific.

When an IFRS specifically applies to a transaction, other event, or condition, the accounting policy or policies applied to that item shall be determined by applying the IFRS and considering any relevant implementation guidance issued by the IASB for the IFRS.

Further, if an IFRS does not address a specific transaction, event, or condition explicitly, IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, states that management should use its judgment in developing and applying an accounting policy that results in information that is relevant and reliable. With respect to the reliability of financial statements, IAS 8 states that the financial statements (a) represent faithfully the financial position, financial performance, and cash flows of the entity; (b) reflect the economic substance of transactions, other events, and conditions; (c) are neutral; (d) are prudent; and (e) are complete in all material respects. When making this type of judgment, management should refer to, and consider the applicability of, the following in descending order:

- The requirements and guidance in IFRSs dealing with similar and related issues
- The definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the IASB Framework
- The most recent pronouncements of other standard setting bodies (for example, U.S. GAAP, other accounting literature, and accepted industry practices) to the extent that these do not conflict with IFRSs

¹ See www.iasb.org for a current listing of International Financial Reporting Standards (IFRSs) and International Accounting Standards (IASs).

² See www.iasb.org for a current listing of International Financial Reporting Interpretations Committee and Standing Interpretations Committee interpretations.

³ Generally speaking, *public* means government-owned entities, and *private* means nongovernment-owned entities.

IFRS for SMEs

IFRS for SMEs is a modification and simplification of full IFRSs aimed at meeting the needs of private company financial reporting users and easing the financial reporting burden on private companies through a cost-benefit approach. *IFRS for SMEs* is a self-contained, global accounting and financial reporting standard applicable to the general purpose financial statements of entities that, in many countries, are known as small- and medium-sized entities (SMEs). Full IFRSs and *IFRS for SMEs* are promulgated by the IASB.

SMEs are entities that publish general purpose financial statements for external users and do not have public accountability. An entity has public accountability under the IASB's definition if it files its financial statements with a securities commission or other regulatory organization or it holds assets in a fiduciary capacity (for example, banks, insurance companies, brokers and dealers in securities, pension funds, and mutual funds). It is not the IASB's intention to exclude entities that hold assets in a fiduciary capacity for reasons incidental to their primary business (for example, travel agents, schools, and utilities) from utilizing *IFRS for SMEs*.

The needs of users of SME financial statements often are different from the needs of users of public company financial statements and other entities that likely would use full IFRSs. Whereas full IFRSs were designed specifically to meet the needs of equity investors in the public capital markets, *IFRS for SMEs* was developed with the needs of a wide range of users in mind. Users of the financial statements of SMEs may be more focused on shorter-term cash flows, liquidity, balance sheet strength, interest coverage, and solvency issues. Full IFRSs may impose a burden on SME preparers in that full IFRSs contain topics and detailed implementation guidance that generally are not relevant to SMEs. This burden has been growing as IFRSs have become more detailed. As such, a significant need existed for an accounting and financial reporting standard for SMEs that would meet the needs of their financial statement users while balancing the costs and benefits from a preparer perspective.

Practically speaking, *IFRS for SMEs* is viewed as an accounting framework for entities that do not have the capacity or resources to use full IFRSs. In the United States, the term SME would encompass many private companies.

In May 2008, the AICPA Governing Council voted to recognize the IASB as an accounting body for purposes of establishing international financial accounting and reporting principles and amended appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards," of Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, ET sec. 202 par. .01), and Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, ET sec. 203 par. .01). This amendment gives AICPA members the option to use IFRSs as an alternative to U.S. GAAP. Accordingly, IFRSs are not considered to be an other comprehensive basis of accounting. Rather, they are a source of GAAP.

As such, a key professional barrier to using IFRSs and, therefore, *IFRS for SMEs*, has been removed. Any remaining barriers may come in the form of unwillingness by a private company's financial statement users to accept financial statements prepared under *IFRS for SMEs* and a private company's expenditure of money, time, and effort to convert to *IFRS for SMEs*.⁴

⁴ CPAs are encouraged to consult their state boards of accountancy to determine the status of reporting on financial statements prepared in accordance with *International Financial Reporting Standard for Small- and Medium-sized Entities* within their individual state.

The AICPA has developed a resource that compares *IFRS for SMEs* with corresponding requirements of U.S. GAAP. This resource is available in a Wiki format, which allows AICPA members and others to contribute to its development. To learn more about the resource, view available sections, and contribute to its content, visit the Wiki at <http://wiki.ifrs.com/>.

The Financial Accounting Standards Board and IASB Convergence Efforts⁵

To address significant differences between IFRSs and U.S. GAAP, the Financial Accounting Standards Board (FASB) and the IASB agreed to a "Memorandum of Understanding" (MoU), which was originally issued in 2006 and subsequently updated. Readers are encouraged to monitor the FASB and IASB websites for additional developments regarding the convergence efforts, such as discussion papers, exposure drafts, and requests for comments.

Comparison of U.S. GAAP and IFRSs

One of the major differences between U.S. GAAP and IFRSs lies in the conceptual approach: U.S. GAAP is based on principles, with heavy use of rules to illustrate the principles; however, IFRSs are principles based, without heavy use of rules.

In general, a principles-based set of accounting standards, such as IFRSs, is broad in scope. The standards are concise, written in plain language, and provide for limited exceptions and bright lines. Principles-based standards typically require a higher level of professional judgment, which may facilitate an enhanced focus on the economic purpose of a company's transactions and how the transactions are reflected in its financial reporting.

A noticeable result of these differences is that IFRSs provide much less overall detail. In developing an IFRS, the IASB expects preparers to rely on core principles and limited application guidance with fewer prescriptive rules. In contrast, FASB often leans more toward providing extensive prescriptive guidance and detailed rules. The guidance provided in IFRSs regarding revenue recognition, for example, is significantly less extensive than U.S. GAAP. IFRSs also contain relatively little industry-specific guidance.

An inherent issue in a principles-based system is the potential for different interpretations of similar transactions across jurisdictions and entities, which may affect the relative comparability of financial reporting.

Because of long-standing convergence projects between the IASB and FASB, the extent of the specific differences between IFRSs and U.S. GAAP is decreasing. Yet, significant differences remain, which could result in significantly different reported results, depending on a company's industry and individual facts and circumstances. For example, some differences include the following:

- IFRSs do not permit last in, first out (LIFO) inventory accounting.
- IFRSs allow for the revaluation of assets in certain circumstances.
- IFRSs use a single-step method for impairment write-downs rather than the two-step method used in U.S. GAAP, making write-downs more likely.

⁵ Because the convergence projects discussed are active and subject to change, updates will be posted periodically to www.journalofaccountancy.com. Readers also are encouraged to monitor the progress of these projects at the respective boards' websites: www.iasb.org and www.fasb.org.

- IFRSs have a different probability threshold and measurement objective for contingencies.
- IFRSs generally do not allow net presentation for derivatives.

U.S. GAAP also addresses some specific transactions not currently addressed in IFRSs, such as accounting for reorganizations, including quasi reorganizations; troubled debt restructuring; spin-offs; and reverse spin-offs. In addition, U.S. GAAP is designed to apply to all nongovernmental entities, including not-for-profit entities, and includes specific guidance for not-for-profit entities, development stage entities, limited liability entities, and personal financial statements.

The difference in the amount of industry-specific guidance also illustrates the different approaches. Currently, IFRSs include only several standards (for example, IAS 41, *Agriculture*)⁶ that might be regarded as primarily industry-specific guidance. However, the scope of these standards includes all entities to which the scope of IFRSs applies. In contrast, U.S. GAAP has considerable guidance for entities within specific industries. For example, on liability recognition and measurement alone, U.S. GAAP contains specific guidance for entities in the following industries, which is not found in IFRSs:

- Health care
- Contractors and construction
- Contractors and the federal government
- Entertainment, with separate guidance for casinos, films, and music
- Financial services, with separate guidance for brokers and dealers and depository and lending, insurance, and investment companies

For nonmonetary transactions, U.S. GAAP provides specific guidance for the airline, software, and entertainment industries.

SEC Work Plan

The SEC continues to affirm its support for a single set of high-quality, globally accepted accounting standards and for the convergence of U.S. GAAP and IFRSs. In February 2010, the SEC issued Release No. 33-9109, *Commission Statement in Support of Convergence and Global Accounting Standards*. This release provides an update to Release No. 33-8982, *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers*. The February 2010 release provides a confirmation of the SEC's continued support for convergence, highlights positive aspects of narrowing the differences between the two sets of standards, and outlines additional considerations required before adoption of a single standard is achieved.

The release also states that a more comprehensive work plan is necessary to lay out the work required to support a decision on the appropriate course to incorporate IFRSs into the U.S. financial reporting system for U.S. issuers, including the scope, timeframe, and methodology for any such transition.

⁶ In addition to IAS 41, *Agriculture*, the other IFRSs that address issues specific to certain industries are IFRS 4, *Insurance Contracts*, and IFRS 6, *Exploration for and Evaluation of Mineral Resources*.

The SEC has indicated that it will carefully consider and deliberate whether a potential transition is in the best interest of U.S. investors and markets.

During 2011, assuming completion of the convergence projects and the SEC staff's work plan, the SEC will decide whether to incorporate IFRSs into the U.S. financial reporting system and, if so, when and how. The work plan is included as an appendix at the end of the SEC's release, which is located on the SEC's website at www.sec.gov.

AICPA

On February 24, 2010, president and CEO of the AICPA Barry Melancon issued a statement on the SEC's plan to work toward the incorporation of IFRSs in the U.S. financial reporting system. The statement noted that the AICPA supports the thoughtful and concrete steps the SEC is taking, as outlined in its plan, to prepare for the transition. The AICPA understands that it will need to fulfill a number of responsibilities to make the use of IFRSs in the United States a success. Ongoing efforts include the following:

- Continuing to educate AICPA members about IFRSs
- Working with accounting educators, textbook authors, and educational institutions to prepare future professionals to use IFRSs
- Making certain the voice of U.S. CPAs is heard internationally
- Incorporating questions about IFRSs into the Uniform CPA Exam

The AICPA believes that it is critical for the SEC to set a specific date for the use of IFRSs in the United States and encourages the SEC, as it completes this work plan in 2011, to ensure investor confidence is maintained and key milestones lead successfully to global standards in 2015. In moving forward, it is essential that all stakeholders—regulators, investors, auditors, educators, financial statement users, and preparers—have the knowledge and tools they need to successfully navigate any change in U.S. accounting rules. The AICPA is doing its part now to prepare these stakeholders for this fundamental shift in financial reporting.

Additional Resources

<i>Website</i>	<i>URL</i>
AICPA	www.aicpa.org
AICPA International Financial Reporting Standards Resources	www.ifrs.com
International Accounting Standards Board	www.iasb.org
Comparison Wiki of <i>International Financial Reporting Standard for Small- and Medium-sized Entities</i> and U.S. generally accepted accounting principles	http://wiki.ifrs.com
Financial Accounting Standards Board	www.fasb.org

Glossary

The following is a list of terms, each with a brief definition, used in the gaming industry. These terms may differ among gaming entities.

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.

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**.

banked games. Activities in which a gaming entity participates in games of chance with a customer, with both the gaming entity and the customer having the chance to win or lose money or other items of economic value as a result of the game output. See also **gaming activities**.

base jackpot. The fixed, minimum amount of a slot machine payout for a specific combination, as defined in the Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) glossary.

base progressive jackpot. The initial dollar amount of a progressive jackpot when the progressive slot machine is first placed in service or when a progressive jackpot resets.

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 changer. A self-service device for use by customers that accepts currency and dispenses smaller denomination currency or coin, or both.

bill validator. The part of a currency acceptor that analyzes the legitimacy of currency and tickets as they are inserted in a slot machine to ensure the currency is not counterfeit.

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.

breakopen. An instant win ticket on which the player tears open a flap to see if the ticket is a winner. Also called **pulltabs**. Breakopens are often sold by charities and occasionally by state lotteries.

buy-in. The amount of money a player must present to purchase 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 convert the weight of coins counted into a specific dollar amount or number of coins counted. See also **weigh count**.

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

candle (tower light). The lighted column mounted on top of a slot machine used to indicate machine malfunctions, machine door openings, and the player's request for change.

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 tokens issued from the casino's 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. 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.

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

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

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.

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

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

checks. Patron personal checks; also slang for **chips**.

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

chip run. A casino's transporting of foreign chips back to the casino of issuance for redemption.

chips. Money substitutes, in various denominations, issued by a gaming entity and used for wagering as defined in the FASB ASC glossary. 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**.

- closer.** The original form on which a table inventory is recorded at the end of a shift.
- coin in.** The amount of coins put into, or wagered on, a slot machine by players.
- 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. See **slot machine**.
- complimentaries (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 marker policies of a casino.
- 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 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.)
- currency acceptor count.** The counting of currency, vouchers, and coupons contained in a currency acceptor drop box.
- currency acceptor drop box.** A locked container within a slot machine that stores currency, vouchers, and coupons inserted into the machine through a bill validator.
- currency acceptor.** An electromechanical 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, which are normally included with the casino's bankroll.
- daily game.** This can refer to any lottery game in which winners are determined once a day, but usually refers to a numbers game such as the "Daily 3" or "Daily 4" games played in many states.
- daily pit summary sheet.** A log retained in the pit that reflects the amount of chips received from and transferred to the cage.
- dead chips.** See **promotional chips**.
- dealer.** An employee who conducts a game in a casino.
- deskpersion.** 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 table game are held until shuffled.

discretionary programs. Discretionary incentives are offered to customers either (1) based on past levels of play or (2) to induce future play. In either case, prior to the incentive being offered to the customer, there is no obligation on the part of the gaming entity to provide the incentive through a loyalty program or otherwise.

diverter. An internal device within a slot machine that channels coins played to the hopper or to the drop bucket when the hopper is full.

dockside gaming. Gaming that occurs on a vessel that is permanently docked or moored. A dockside vessel does not have the requirement to cruise.

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

drop. (1) In slots, the total amount of cash, tokens, and wagering vouchers removed from the drop bucket and the currency acceptor drop box. The term may also include the dollar amount of wagering credits transferred to a slot machine from a wagering account. (2) In table games, the total amount of cash, chips, and wagering vouchers contained in the drop box. The term may also include the amount of credit issued at the table.

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 that overflow 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.

electronic money transfer. A transfer of funds between a wagering account and game through a cashless wagering system.

erasable programmable read-only memory (EPROM). Computer chips used in slot machines containing the random number generator and other slot machine game programs.

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

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 cabinet. See **hopper storage area**.

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. Casino chips of other casinos.

free play. Free wagering offered by a gaming entity to provide cashable benefits that increase the customer's odds of winning, changing the basic odds of the game.

- front money.** A customer deposit that is used in lieu of credit to guarantee payment of a marker issued.
- futures.** A bet on an event that has not yet occurred.
- game bankroll (table bankroll).** The inventory of coins, tokens, and 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 markers are included in the game bankroll until they are transferred to the cage.
- game count sheet.** See **master game report**.
- gaming activity.** A gaming entity participates in games of chance with customers with both the gaming entity and the customer having the chance to win or lose money or other items of economic value based on the outcome of the game (commonly referred to as *banked games*). See also **banked games**. A gaming entity participates in games of chance with customers, with both the gaming entity and the customer having the chance to win or lose money or other items of economic value based on the outcome of the game (commonly referred to as *banked games*). Also see **banked games**).
- gaming related activity.** Games in which the customer has the chance to win or lose money or other items of economic value, with the gaming entity receiving a fee (typically, either a fixed fee or a percentage of play) for administering the game, rather than the gaming entity being at risk to win or lose based on the outcome of the game are neither banked games nor gaming activities. Games in which the customer has the chance to win or lose money or other items of economic value, with the gaming entity receiving a fee (typically either a fixed fee or a percentage of play) for administering the game, rather than the gaming entity being at risk to win or lose based on the outcome of the game, are neither banked games nor gaming activities.
- gross gaming revenue.** The win from gaming activities, which is the difference between gaming wins and losses before deducting costs and expenses or deducting incentives or adjusting for changes in progressive jackpot liability accruals. Generally, the difference between patron wagers and the payouts made on winning wagers. Formulas for computing such revenue vary depending on the game type. See **win**.
- handle.** The total amount wagered.
- hand paid jackpot.** 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.
- hard count.** The count of coins and tokens contained in drop buckets.
- hit.** A winning combination of symbols on the payline.
- hit frequency.** The rate at which a slot machine will produce a payout, expressed as a percentage of time. Also referred to as *hit rate*.
- hold check.** A check held in the custody of the casino at the request of a customer that has not been deposited with the casino's bank.

- hold percentage.** The relationship of gross gaming revenue to table drop or slot handle.
- hopper (payout reserve container).** The receptacle inside a slot machine containing coins or tokens used to make payouts.
- hopper fill slip.** A document used to record the monetary value of coins or tokens put into a hopper.
- hopper load.** Coins or tokens put in a slot machine hopper when the machine is initially placed on the casino floor.
- hopper storage area (fill cabinet).** A secure compartment located adjacent to the drop bucket compartment of a slot machine that is used for temporary storage of coin or tokens to be used for hopper fills.
- house.** A casino.
- incremental progressive jackpot.** The difference between the total amount of the progressive jackpot displayed and the base progressive amount.
- independent agent.** Independent contractor who performs marketing activities or marker collection activities, or both, on behalf of a gaming entity.
- inside ticket.** A keno ticket retained by the house showing the customer's selection of numbers and the amount wagered.
- instant game.** A lottery ticket that requires the player to remove a latex coating to determine if the ticket is a winner. Also called **scratch-off game** or **scratcher**.
- issue slip.** A copy of a marker that is retained for numerical sequence control purposes, documenting the details of the issuance of credit.
- jackpot.** Payout resulting from a winning wager.
- jackpot payout.** Slot machine payments of money, tokens, payout receipts, wagering vouchers, and electronic money transfers made from a slot machine to a wagering account.
- jackpot payout slip.** A form on which the portion of a jackpot paid by slot personnel is recorded.
- keno lottery.** A lotto game in which a set of numbers (typically 20) is selected from a large field of numbers (typically 80). Players select a smaller set of numbers (usually up to 10) and are awarded prizes based on how many of their numbers match those in the drawn set. With several state lotteries, keno is played at frequent intervals, with drawings as close together as every 4–5 minutes. With other lotteries, keno is played as a daily or weekly game.
- 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 disk that is placed on a gaming table to indicate that the dollar amount of chips designated thereon has

been given to the customer for wagering on credit prior to completion of a marker.

layoff bet. 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.

limited stakes. Refers to a maximum betting limit (for example, \$5 maximum per hand) that is placed on a particular game, set of games, or for all games in a particular gaming jurisdiction.

local area progressive jackpot. The progressive jackpot generated from a local area progressive system.

local area progressive system. Progressive slot machines that are operated at a single location and connected by a linked network.

lottery agent. A retail outlet that sells lottery tickets.

lottery commission. The fee paid to retail outlets for selling lottery tickets.

lottery terminal. A computerized device located at a lottery retailer that is used to sell online games and validate winning tickets of online and instant games. Terminals are connected to a lottery's central computers by phone line.

lotto. A lottery game in which players select a group of numbers from a large set and are awarded prizes based on how many of the selected numbers match a second set chosen by a random drawing. In a typical lotto game, a player might be asked to select 6 numbers from a set of 49. At a predetermined time, 6 numbers are randomly selected by the lottery. The player wins a major prize if all 6 of the player's numbers match those chosen in the random drawing. The player wins smaller prizes for matching 3, 4, or 5 of the drawn numbers.

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. A document, usually signed by the customer, evidencing an extension of credit to him or her by the casino.

marker button. See **lammer button.**

marker custodian. See **pit clerk.**

marker log. A detailed list of all marker transactions.

marker play. The wagering of chips obtained in exchange for a marker.

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 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.

meter. A mechanical apparatus or software contained within a slot machine that may record such values as the number of coins wagered, the dollar amount of currency or vouchers inserted, the number of coins dropped, the number of times the handle was pulled, or the number of coins paid out to winning players.

money laundering. The disguising or concealing of illicit income in order to make it appear legitimate.

money play. Cash wagers at a table game.

net gaming revenue. Generally, gross gaming revenues less cash sales incentives and the change in progressive jackpot liabilities and revenue from gaming related activities. Cash sales incentives include discounts and match play in table games or free play and slot club points in slot transactions.

nondiscretionary programs. Nondiscretionary incentive programs offer incentives based on past gaming activity. The primary form of nondiscretionary incentive program is a point-based loyalty program, in which customers earn points as they play and can redeem those points for something of value, whether cash, free play, or other incentives, such as complimentary.

nonprogressive jackpot. The predetermined fixed payouts depicted on the pay table of the machine (such as the payouts based on reel combinations in a mechanical slot machine).

off-line game. A lottery game that does not require the use of a computer terminal for purchase. Instant and passive games are examples of off-line games.

online game. A lottery game in which tickets are purchased through a network of computer terminals located at retail outlets. The terminals are linked to a central computer that records the wagers. Examples of online games are lotto and keno.

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.

passive game. A lottery game similar to a raffle in which a player buys a ticket with preprinted numbers. The lottery randomly draws numbers that are compared to the players' tickets to determine the outcomes.

participation arrangement. An arrangement in which a gaming entity pays a fee to the manufacturer or owner or seller to use a slot machine and its related game.

payline. The horizontal rule across the center of the reel window. The symbols must line up on the line to hit a jackpot payout. Some slot machines will

have multiple paylines that may be above and below the center payline and may even cross it diagonally.

payment slip. That part of a marker form on which details of a customer's payment are recorded.

payoff. The amount paid out on a winning wager.

payout percentage. The expected average percentage of money taken in that a casino's slot machines pay back to players over time. The percentage does not mean that all of the casino's machines pay back that amount. It is an average that is calculated over the long-run for each machine, given a certain number of plays.

payout receipt. An instrument with cash redemption value that is either printed at a slot machine or at a central location from where a payout can be made. A payout receipt cannot be accepted by a slot machine for wagering purposes.

payout schedule. A statement, printed on cards, paper, plexiglass, table layouts, or signs of the payoffs or awards applicable to a particular game or device.

paytable glass. Located on the top portion of the slot machine and generally made of plastic, this provides the player with a listing of the payout possibilities at that particular machine as well as the combinations necessary to achieve a particular payout. It also provides the customer with an overview of the various symbols contained on the machine's reels.

pit. An area in a casino where gaming tables are located.

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 markers.

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

pit report. See **master game report**.

plaques. 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 jackpot. A jackpot that is generated from a single slot machine or group of machines that are connected by a linked network. The jackpot grows each time a player bets on the machines.

progressive meter. A game payout schedule of a progressive jackpot.

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

progressive system. Two or more slot machines linked to a common progressive meter that combine to form one jackpot.

promotional chips. Chips issued for wagering that have no cash redemption value; typically used in conjunction with promotions and table game tournaments.

pulltab. See **breakopen**.

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

quick pick. A method for playing online lottery games in which players choose to have a computer randomly select their numbers rather than picking the numbers themselves.

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 animal races and sporting events.

racino. A racetrack where slot machines, video lottery terminals (VLTs), and, in some cases, table games, have been installed. (The word *racino* is a combination of the words *racetrack* and *casino*.)

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

redemption kiosk. A self-service device for use by patrons that redeems wagering vouchers for currency.

reel cycle. The theoretical playing of a slot machine with each possible combination occurring once before there are any repetitions.

reel settings. The positions on a slot machine wheel controlling the outcome of winning combinations.

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

reels. The spinning wheels that contain the slot machine's symbols. On video style slot machines, the reels are simulated and used for the visual effect to display the result of the digital reels that are actually stored in computer memory and "spun" by a random number generator.

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. A document used in the pit to record a patron's rim credit activity.

rim credit. An extension of credit at a table game in exchange for chips not evidenced by the immediate preparation of a marker.

riverboat gaming. Licensed gaming that occurs on a vessel that has the capacity to cruise.

safe keeping deposit. See **customer deposits**.

scratch-off game. See **instant game**.

- server based gaming.** Slot operations consisting of system based games or system supported games, or both.
- shift boss (manager).** The executive with overall responsibility for casino operations during a shift.
- skill (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.
- 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.** The process whereby coins and tokens (over and above a minimum amount left in the machine for future play), currency, and tickets are removed from the slot machine, collected (dropped), and counted.
- slot drop count.** See **hard count**.
- slot drop win report (slot win sheet).** The accounting record of slot machine winnings. The slot win sheet or win report can include the amount of coins or tokens retained by the casino, meter readings, hand paid jackpots, hopper fills, currency and tickets dropped, and the net win and win percentage by denominations for the period.
- slot fill and payout sheet.** A list of the slot fills and slot payouts.
- slot fill.** The coins placed in a hopper.
- slot machine load.** See **hopper load**.
- slot machine.** A type of mechanical or electrical apparatus used in connection with gaming as defined in the FASB ASC glossary.
- slot supervisor.** An individual with responsibility for a slot area and jackpots.
- soft count.** The count of the contents in a drop box.
- sports lottery.** Lottery games in which outcomes are determined by the results of sports events. Sports lotteries are the most popular lottery games in much of the world (where they are called *toto* or *football pools*), but have not achieved this level of popularity in North America. They are offered throughout Canada, but in the United States are only sold in Delaware and Oregon.
- 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**.

stops. Collectively refers to the areas on a slot machine's physical reel that contain the symbols and blank spaces. A stop refers to a particular area on a slot machine reel containing either a symbol or a blank space. Any combination of stops can line up on a payline.

symbol. Each slot machine has a theme that accompanies it. Each theme has a set of images or graphics called "symbols" that represent the theme and are placed on the reels.

system based game. A gambling game comprising a server (or system) and client stations resembling slot machines that, together, form a single integrated device in which the system portion of the game determines the outcomes of the individual games conducted on the client stations. The client stations cannot operate independently from the system with this type of game.

system supported game. A gambling game comprising a collection of conventional slot machines, or client stations resembling slot machines, connected to a system for the purpose of downloading control programs and other software resources to the conventional slot machine or client station on an intermittent basis. The slot machines and client stations connected to the system are capable of operating independently from the system once the downloading process has been completed.

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 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.

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.

ticket. See **wagering voucher**.

ticket acceptor. See **currency acceptor**.

ticket in/ticket out (TITO). A cashless wagering system that utilizes wagering vouchers.

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

tokens. A coin-like money substitute, in various denominations, used for gaming transactions.

top box. The upper portion of the slot machine (located above the pay table) that displays the name or theme of the respective machine. The top box can be changed according to what theme is popular at a given point in time, providing the player-base with variety. The top box and the reel symbols are generally uniform, particularly with the themed games. For example, if you change the top box display from "Wheel of Fortune" to "Jeopardy," the reels must also be altered to carry symbols that correlate with the "Jeopardy" theme.

- third party licensing arrangement.** An arrangement in which a gaming entity pays a fee to the owner or seller for the right to use intellectual property or a copyrighted game, such as a game used in a slot machine that the casino owns.
- unpaid.** A customer who has won but has not been paid.
- vault.** A secure area within the casino where currency, coins, and chips are stored.
- video lottery terminal (VLT).** An electronic game of chance played on a video screen, similar to a video slot machine that is connected to a lottery's central computer. Unlike slot machines, video lottery terminals do not dispense money. Rather, a winning player is provided a ticket that is redeemed by the retail outlet for prizes.
- wagering account transfer.** An electronic transfer of wagering credits between a cashless wagering system wagering account and a game.
- wagering account.** An electronic ledger for a cashless wagering system patron deposit account reflecting deposits, withdrawals, and wagering account transfers to and from a game.
- wagering coupon.** A printed wagering instrument with no cash redemption value used with games interfaced with a cashless wagering system.
- wagering voucher.** A printed wagering instrument with cash redemption value used with games interfaced with a cashless wagering system. Also known as a **ticket**.
- weigh count.** The value of coins and currency counted by a weigh machine.
- whiz machine.** See **slip dispenser**.
- wide area progressive jackpot.** A jackpot generated from a wide area progressive system.
- wide area progressive system.** Progressive slot machines that are operated at multiple locations and are connected by a linked network.
- wide area progressive (WAP) arrangement.** An arrangement in which a gaming entity pays a fee to the WAP operator for providing a wide area progressive system.
- win.** The net win from gaming activities, which is the difference between gaming wins and losses before deducting costs and expenses. Also called **gross gaming revenue**. This definition is defined in the FASB ASC glossary.
- 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, or 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.

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