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Gaming, September 1, 2017: Audit and Accounting Guide

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Audit and Accounting Guide

Gaming

September 1, 2017

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Audit and Accounting Guide

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ISBN 978-1-94549-890-9

Preface



(Updated as of September 1, 2017)

About AICPA Guides

This AICPA Guide 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 performing and reporting on their audit engagements.

AICPA guides may include certain content presented as a "Supplement," "Appendix," or "Exhibit." A supplement is a reproduction, in whole or in part, of authoritative guidance originally issued by a standard setting body (including regulatory bodies) and applicable to entities or engagements within the purview of that standard setter, independent of the authoritative status of the applicable AICPA Guide. Both appendixes and exhibits are included for informational purposes and have no authoritative status.

The Financial Reporting Executive Committee (FinREC) is the designated senior committee of the AICPA authorized to speak for the AICPA in the areas of financial accounting and reporting. Conforming changes made to the financial accounting and reporting guidance contained in this guide are reviewed by the FinREC chair (or his or her designee). Updates made to the financial accounting and reporting guidance in this guide exceeding that of conforming changes are approved by the affirmative vote of at least two-thirds of the members of FinREC.

This guide does the following:

- Identifies certain requirements set forth in FASB *Accounting Standards Codification*[®] (ASC).
- Identifies certain requirements set forth in GAAP for governmental entities established or cleared by 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 and GAAP for governmental entities.

Accounting guidance for nongovernmental entities included in an AICPA 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 US Securities and Exchange Commission (SEC) for SEC registrants.

Accounting guidance for governmental entities included in an AICPA Guide, and cleared by GASB, is a source of authoritative GAAP described in category B of the hierarchy of GAAP for state and local governmental entities as defined in GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The accounting provisions of this guide that have been cleared by GASB are formatted in orange font for the reader within the text of the guide and are noted in appendix A, "Category B Guidance." AICPA members should be prepared to justify departures from GAAP as discussed in the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001).

An AICPA Guide containing auditing guidance related to generally accepted auditing standards (GAAS) is recognized as an interpretive publication as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*). Interpretive publications are recommendations on the application of GAAS in specific circumstances, including engagements for entities in specialized industries.

Interpretive publications are issued under the authority of the AICPA 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 GAAS. The members of the ASB have found the auditing guidance in this guide to be consistent with existing GAAS.

Although interpretive publications are not auditing standards, AU-C section 200 requires the auditor to consider applicable interpretive publications in planning and performing the audit because interpretive publications are relevant to the proper application of GAAS in specific circumstances. If the auditor does not apply the auditing guidance in an applicable interpretive publication, the auditor should document how the requirements of GAAS were complied with in the circumstances addressed by such auditing guidance.

The ASB is the designated senior committee of the AICPA authorized to speak for the AICPA on all matters related to auditing. Conforming changes made to the auditing guidance contained in this guide are approved by the ASB chair (or his or her designee) and the director of the AICPA Audit and Attest Standards Staff. Updates made to the auditing guidance in this guide exceeding that of conforming changes are issued after all ASB members have been provided an

opportunity to consider and comment on whether the guide is consistent with the Statements on Auditing Standards (SASs).

Any auditing guidance in a guide appendix or exhibit (whether a chapter or back matter appendix or exhibit), though not authoritative, is considered an "other auditing publication." In applying such guidance, the auditor should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. Although the auditor determines the relevance of other auditing guidance, auditing guidance in a guide appendix or exhibit has been reviewed by the AICPA Audit and Attest Standards staff and the auditor may presume that it is appropriate.

An AICPA Guide containing attestation guidance is recognized as an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attestation Engagements* (AICPA, *Professional Standards*). Interpretive publications are recommendations on the application of Statements on Standards for Attestation Engagements (SSAEs) in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are issued under the authority of the ASB. The members of the ASB have found the attestation guidance in this guide to be consistent with existing SSAEs.

A practitioner should be aware of and consider the guidance in this AICPA Guide applicable to his or her attestation engagement. If the practitioner does not apply the guidance included in an applicable AICPA Guide, the practitioner should be prepared to explain how he or she complied with the SSAE provisions addressed by such attestation guidance.

Any attestation guidance in a guide appendix or exhibit (whether a chapter or back matter appendix or exhibit), though not authoritative, is considered an "other attestation publication." In applying such guidance, the practitioner should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement. Although the practitioner determines the relevance of other attestation guidance, such guidance in a guide appendix or exhibit has been reviewed by the AICPA Audit and Attest Standards staff and the practitioner may presume that it is appropriate.

The ASB is the designated senior committee of the AICPA authorized to speak for the AICPA on all matters related to attestation. Conforming changes made to the attestation guidance contained in this guide are approved by the ASB chair (or his or her designee) and the director of the AICPA Audit and Attest Standards Staff. Updates made to the attestation guidance in this guide exceeding that of conforming changes are issued after all ASB members have been provided an opportunity to consider and comment on whether the guide is consistent with the SSAEs.

Recognition

2017 Guide Edition

AICPA Senior Committees

Auditing Standards Board

Michael J. Santay, *Chair*
Dora Burzenski, *Member*

Financial Reporting Executive Committee

James Dolinar, *Chair*

The AICPA gratefully acknowledges those members of the Gaming Guide Task Force who reviewed or otherwise contributed to the development of this edition of the guide: Bruce Bleakman, John Page, Patrick Pruitt, and Michael Winter-scheidt.

The AICPA gratefully appreciates the invaluable assistance Renee Rampulla provided in updating and maintaining the guidance in the 2017 edition of the guide.

AICPA Staff

Susan Reed

Manager

Product Management and Development—Public Accounting

Guidance Considered in This Edition

This edition of the guide has been modified by the AICPA staff to include certain changes necessary due to the issuance of authoritative guidance since the guide was originally issued (September 1, 2011, edition), and other revisions as deemed appropriate. Relevant guidance issued through September 1, 2017, has been considered in the development of this edition of the guide. However, this guide does not include all audit, accounting, reporting, regulatory, and other requirements applicable to an entity or a particular engagement. This guide is intended to be used in conjunction with all applicable sources of relevant guidance.

Relevant guidance that is issued and effective on or before September 1, 2017, is incorporated directly in the text of this guide. Relevant guidance issued but not yet effective as of September 1, 2017, but becoming effective on or before December 31, 2017, is also presented directly in the text of the guide, but shaded gray and accompanied by a footnote indicating the effective date of the new guidance. The distinct presentation of this content is intended to aid the reader in differentiating content that may not be effective for the reader's purposes (as part of the guide's "dual guidance" treatment of applicable new guidance).

Relevant guidance issued but not yet effective as of the date of the guide and not becoming effective until after December 31, 2017, is referenced in a "guidance update" box; that is, a box that contains summary information on the guidance issued but not yet effective.

In updating this guide, all guidance issued up to and including the following was considered, but not necessarily incorporated, as determined based on applicability:

- FASB Accounting Standards Update (ASU) No. 2017-11, *Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*
- GASB statements, interpretations, and technical bulletins issued through September 1, 2017

- GASB Implementation Guidance Update No. 2017-2, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, issued April 2017
- SAS No. 133, *Statement on Auditing Standards, Auditor Involvement With Exempt Offering Documents* (AICPA, *Professional Standards*, AU-C sec. 945)
- Statement of Position 13-2, *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Mapping, Consistency, or Structure of XBRL-Formatted Information* (AICPA, *Professional Standards*, AUD sec. 55)
- SSAE No. 18, *Attestation Standards: Clarification and Recodification* (AICPA, *Professional Standards*)
- PCAOB Release No. 2017-01, *The Auditor's Report on an Audit of Financial Statements When an Auditor Expresses and Unqualified Opinion*

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

The changes made to this edition of the guide are identified in appendix J, "Schedule of Changes Made to the Text From the Previous Edition." The changes do not include all those that might be considered necessary if the guide were subjected to a comprehensive review and revision.

FASB standards quoted are from *FASB Accounting Standards Codification* ©2015, Financial Accounting Foundation. All rights reserved. Used by permission.

GASB standards quoted are from *GASB Statements, Concepts Statements, Interpretations, and Technical Bulletins*, © 2017, Financial Accounting Foundation. All rights reserved. Used by permission.

FASB ASC Pending Content

Presentation of Pending Content in FASB ASC

Amendments to FASB ASC (issued in the form of ASUs) are initially incorporated into FASB ASC in "pending content" boxes below the paragraphs being amended with links to the transition information. The pending content boxes are meant to provide users with information about how the guidance in a paragraph will change as a result of the new guidance.

Pending content applies to different entities at different times due to varying fiscal year-ends, and because certain guidance may be effective on different dates for public and nonpublic entities. As such, FASB maintains amended guidance in pending content boxes 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 could still be applied.

Presentation of FASB ASC Pending Content in AICPA Guides

Amended FASB ASC guidance that is included in pending content boxes in FASB ASC on September 1, 2017, is referenced as "Pending Content" in this guide. Readers should be aware that "Pending Content" referenced in this guide

will eventually be subjected to FASB's roll-off process and no longer be labeled as "Pending Content" in FASB ASC (as discussed in the previous paragraph).

Terms Used to Define Professional Requirements in This AICPA Guide

Any requirements described in this guide are normally referenced to the applicable standards or regulations from which they are derived. Generally the terms used in this guide describing the professional requirements of the referenced standard setter (for example, the ASB) are the same as those used in the applicable standards or regulations (for example, *must* or *should*). However, where the accounting requirements are derived from FASB ASC, this guide uses *should*, whereas FASB uses *shall*. In its resource document "About the Codification" that accompanies FASB ASC, FASB states that it considers the terms "should" and "shall" to be comparable terms and to represent the same concept—the requirement to apply a standard.

Readers should refer to the applicable standards and regulations for more information on the requirements imposed by the use of the various terms used to define professional requirements in the context of the standards and regulations in which they appear.

Certain exceptions apply to these general rules, particularly in those circumstances where the guide describes prevailing and/or preferred industry practices for the application of a standard or regulation. In these circumstances, the applicable senior committee responsible for reviewing the guide's content believes the guidance contained herein is appropriate for the circumstances.

Applicability of GAAS and PCAOB Standards

Appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards," of the AICPA Code of Professional Conduct recognizes both the ASB and the Public Company Accounting Oversight Board (PCAOB) as standard setting bodies designated to promulgate auditing, attestation, and quality control standards. Paragraph .01 of the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) requires an AICPA member who performs an audit to comply with the applicable standards.

Audits of the financial statements of those entities subject to the oversight authority of the PCAOB (that is, those audit reports within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended), are to be conducted in accordance with standards established by the PCAOB, a private sector, nonprofit corporation created by the Sarbanes-Oxley Act of 2002. The SEC has oversight authority over the PCAOB, including the approval of its rules, standards, and budget. In citing the auditing standards of the PCAOB, references generally use section numbers within the reorganized PCAOB auditing standards and not the original standard number, as appropriate.

Audits of the financial statements of those entities not subject to the oversight authority of the PCAOB (that is, those audit reports not within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended)—hereinafter referred to as nonissuers¹—are to be conducted in accordance with

¹ See the definition of the term *nonissuer* in the AU-C Glossary (AICPA, *Professional Standards*).

GAAS as issued by the ASB. 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 AICPA *Professional Standards*. In citing GAAS and their related interpretations, references generally use section numbers within the codification of currently effective SASs and not the original statement number, as appropriate.

The auditing content in this guide primarily discusses GAAS issued by the ASB and is applicable to audits of nonissuers. Users of this guide may find the tool developed by the PCAOB's Office of the Chief Auditor helpful in identifying comparable PCAOB Standards. The tool is available at pcaobus.org/standards/auditing/pages/findanalogousstandards.aspx

Considerations for audits of entities in accordance with PCAOB standards may also be discussed within this guide's chapter text. When such discussion is provided, the related paragraphs are designated with the following title: *Considerations for Audits Performed in Accordance With PCAOB Standards*. PCAOB guidance included in an AICPA Guide has not been reviewed, approved, disapproved, or otherwise acted upon by PCAOB and has no official or authoritative status.

Applicability of Quality Control Standards

QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. A system of quality control consists of policies that a firm establishes and maintains to provide it with reasonable assurance that the firm and its personnel comply with professional standards, as well as applicable legal and regulatory requirements. The policies also provide the firm with reasonable assurance that reports issued by the firm are appropriate in the circumstances.

QC section 10 applies to all CPA firms with respect to engagements in their accounting and auditing practice. In paragraph .13 of QC section 10, an accounting and auditing practice is defined as "a practice that performs engagements covered by this section, which are audit, attestation, compilation, review, and any other services for which standards have been promulgated by the AICPA ASB or the AICPA Accounting and Review Services Committee under the "General Standards Rule" (ET sec.1.300.001) or the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice."

In addition to the provisions of QC section 10, readers should be aware of other sections within AICPA *Professional Standards* that address quality control considerations, including the following provisions that address engagement level quality control matters for various types of engagements that an accounting and auditing practice might perform:

- AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*)
- AT-C section 105

- AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*)

Because of the importance of engagement quality, this guide includes appendix H, "Overview of Statements on Quality Control Standards." This appendix summarizes key aspects of the quality control standard. This summarization should be read in conjunction with QC section 10, AU-C section 220, AT-C section 105, AR-C section 60, and the quality control standards issued by the PCAOB, as applicable.

Applicability of Government Auditing Standards

In addition to GAAS, governmental gaming entities may also be required, or voluntarily elect, to have their audits performed in accordance with *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States. Auditors who perform audits under *Government Auditing Standards* should refer to AICPA Audit Guide *Government Auditing Standards and Single Audits*.

AICPA.org Website

The AICPA encourages you to visit the website at www.aicpa.org, and the Financial Reporting Center at www.aicpa.org/frc. The Financial Reporting Center supports members in the execution of high-quality financial reporting. Whether you are a financial statement preparer or a member in public practice, this center provides exclusive member-only resources for the entire financial reporting process, and provides timely and relevant news, guidance and examples supporting the financial reporting process. Another important focus of the Financial Reporting Center is keeping those in public practice up to date on issues pertaining to preparation, compilation, review, audit, attestation, assurance and advisory engagements. Certain content on the AICPA's websites referenced in this guide may be restricted to AICPA members only.

Alternatives Within U.S. GAAP for Private Companies

The Private Company Council (PCC), established by the Financial Accounting Foundation's Board of Trustees in 2012, and FASB, working jointly, will mutually agree on a set of criteria to decide whether and when alternatives within U.S. GAAP are warranted for private companies. Based on those criteria, the PCC reviews and proposes alternatives within U.S. GAAP to address the needs of users of private company financial statements. These U.S. GAAP alternatives may be applied to those entities that are not public business entities, not-for-profits, or employee benefit plans.

The FASB ASC master glossary defines a *public business entity* as

A public business entity is a business entity meeting any one of the criteria below. Neither a not-for-profit entity nor an employee benefit plan is a business entity.

- a) It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including

voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).

- b) It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c) It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d) It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
- e) It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Considerations related to alternatives for private companies may be discussed within this guide's chapter text. When such discussion is provided, the related paragraphs are designated with the following title: Considerations for Private Companies that elect to use Standards as Issued by the Private Company Council.

Select Recent Developments Significant to This Guide

AICPA's Ethics Codification Project

The AICPA's Professional Ethics Executive Committee (PEEC) restructured and codified the AICPA Code of Professional Conduct (code) so that members and other users of the code can apply the rules and reach appropriate conclusions more easily and intuitively. This is referred to as the *AICPA Ethics Codification Project*.

Although PEEC believes it was able to maintain the substance of the existing AICPA ethics standards through this process and limited substantive changes to certain specific areas that were in need of revision, the numeric citations and titles of interpretations have all changed. In addition, the ethics rulings are no longer in a question and answer format but rather, have been drafted as interpretations, incorporated into interpretations as examples, or deleted where deemed appropriate. For example:

- Rule 101, *Independence* (ET sec. 101.01) is referred to as the "Independence Rule" (ET sec. 1.200.001) in the revised code.

- The content from the ethics ruling entitled "Financial Services Company Client has Custody of a Member's Assets" (ET sec. 191.081–.082) is incorporated into the "Brokerage and Other Accounts" interpretation (ET sec. 1.255.020) found under the subtopic "Depository, Brokerage, and Other Accounts" (ET sec. 1.255) of the "Independence" topic (ET sec. 1.200).

The revised code is effective December 15, 2014, and is available at <http://pub.aicpa.org/codeofconduct>. References to the code have been updated in this guide, as applicable. To assist users in locating in the revised code content from the prior code, PEEC created a mapping document. The mapping document is available in Excel format in appendix D in the revised code.

Attestation Clarity Project

To address concerns over the clarity, length, and complexity of its standards, the ASB established clarity drafting conventions and undertook a project to redraft all the standards it issues in clarity format. The redrafting of SSAEs (or attestation standards) in SSAE No. 18 represents the culmination of that process.

The attestation standards are developed and issued in the form of SSAEs and are codified into sections. SSAE No. 18 recodifies the "AT" section numbers designated by SSAE Nos. 10–17 using the identifier "AT-C" to differentiate the sections of the clarified attestation standards (AT-C sections) from the attestation standards that are superseded by SSAE No. 18 (AT sections).

The AT sections in AICPA *Professional Standards* remain effective through April 2017, by which time substantially all engagements for which the AT sections were still effective are expected to be completed. The clarified attestations found in AT-C sections are effective for practitioners' reports dated on or after May 1, 2017.

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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. As of 2017, 7 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 include slot machines, table games, race and sports books, bingo, and keno. (See table 1-1 in paragraph 1.19)

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

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 non-banked card games that are played exclusively against other players, such as 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 44 states and the District of Columbia operate some form of a lottery. Additionally, lottery associations operate inter-state 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 G, "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 major prize is won on a ticket sold 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 might 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, over the Internet, 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	Online Gaming	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	X	
District of Columbia					X	X			
Florida			X	X	X	X		X	
Georgia					X	X			
Hawaii									X

(continued)

Nature of Legalized Gaming Throughout the United States—continued

State	Land based ¹	Riverboat	Native American ²	Card room	Lottery ³	Bingo	Online Gaming	Racino ⁴	None
Idaho			X		X	X			
Illinois		X			X	X			
Indiana		X			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	X		X	
Massachusetts	X		X		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			X	X		
New Hampshire					X	X			
New Jersey	X				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			
West Virginia	X				X	X		X	
Wisconsin			X		X	X			
Wyoming			X		X	X			
Number of states	12	7	30	5	45	48	3	13	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, and Nebraska.

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 was deemed to be illegal in the United States especially as a result of the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA). Subsequent federal government bills and interpretations of the UIGEA have provided for the legalization and regulation of online poker and some other forms of online gaming at the individual state level. As of the end of 2016, the states of Nevada, New Jersey, and Delaware have legalized online gaming conducted and operated within their state. Other states are studying and looking at the possibility of legalizing online gaming operations to be conducted within their states. The Federal Wire Act prohibits the electronic transmission of information for sports betting across telecommunication lines. The U.S. Department of Justice has taken the position that the Federal Wire Act applies to all forms of online interstate gaming, but does permit activities within those states that have approved the legalization of online gaming conducted and operated within their states.

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. Currently, state laws dictate and regulate the conduct of online gaming conducted and offered within the individual state. Online gaming conducted across state lines is considered illegal in accordance with the UIGEA.

1.27 Officers, directors, and certain key employees of a gaming entity must be licensed by the gaming regulatory authorities, and employees associated

² 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.

with gaming must often 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 E, "The New Jersey Casino Reinvestment Development Authority," 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 F, "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. Online gaming functions similar to a normal gaming entity in terms of the games offered. The individual laws and regulations of each jurisdiction determine what games can be legally offered online. Refer to paragraph 1.46 for additional information. More detailed descriptions of some of these games are included in appendix G.

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
- Pai-Gow Poker
- 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. However, technological advances have been made that allow 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.

Online Real Money Gaming

1.46 Online gaming generally consists of the online versions of the same games seen in regular gaming entities. Examples of the most prevalent online gaming include: Seven Card Stud; Omaha and Texas Hold 'Em which are offered in a variety of formats such as cash or "ring" games; single table tournaments that are often referred to as "Sit and Go's" and multi-table tournaments. Real money games also offer Blackjack, baccarat, Pai-Gow, Hi-Lo, Roulette, Keno, and others.

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). GAAP is established for nongovernmental entities by FASB *Accounting Standards Codification* 105, *Generally Accepted Accounting Principles*, and by GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, for governmental entities.

2.03 Gaming in the United States is conducted by commercially owned entities and by state, local, and tribal governments and their enterprises. Chapter 1, "Overview and Introduction," of the AICPA Audit and Accounting Guide *State and Local Governments* specifies criteria for classifying entities as governmental.¹ Under those criteria, gaming entities operated by state, local, and tribal² 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.³

¹ The definition of *government* can also be found in the 2017–18 GASB Codification at 1000.801.

² Federally recognized tribes (including federally recognized Alaskan native villages and corporations) are governmental because each has the power to enact and enforce a tax levy and can issue debt bearing interest that is exempt from federal taxation, which are criteria for being considered governmental.

³ Technical Questions and Answers (Q&A) sections 9160.31–35 (AICPA, *Technical Questions and Answers*) provide nonauthoritative guidance that addresses reporting on financial statements developed using an inappropriate set of standards. The Q&As also discuss whether an entity is a state or local governmental entity for purposes of determining whether it is using the appropriate set of accounting standards, and how to report on the entity's financial statements when the entity elects to follow either a different set of standards or a special purpose framework. The following topics are covered in the Q&As:

- 9160.31, "Following Accounting Standards as Promulgated by FASB by a State or Local Governmental Entity"
- 9160.32, "Reporting on Accounting Standards as Promulgated by FASB by a State or Local Government"
- 9160.33, "Engagement Acceptance When a State or Local Government Elects to Follow a Special Purpose Framework"
- 9160.34, "Accounting Standards as Promulgated by FASB as a Special Purpose Framework"
- 9160.35, "Reporting on Indian Tribe Financial Statements Prepared in Accordance With Accounting Standards as Promulgated by FASB"

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, as well as certain sections of chapter 3, "Overview of Gaming and Gaming Related Revenue."

Chapter 3

Overview of Gaming and Gaming Related Revenue

FASB Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers

(Note: Not applicable to governmental entities)

The "Pending Content" that links to FASB ASC 606-10-65-1 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period, for a public business entity; a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market; and an employee benefit plan that files or furnishes financial statements with or to the SEC. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

For other entities, FASB ASC 606 is effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Other entities may elect to adopt the standard earlier, however, only as of either

- an annual reporting period beginning after December 15, 2016, including interim periods within that reporting period, or
- an annual reporting period beginning after December 15, 2016, and interim periods within annual periods beginning one year after the annual reporting period in which an entity first applies the "Pending Content" that links to FASB ASC 606-10-65-1.

FASB ASC 606 provides a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics, including FASB ASC 924, *Entertainment—Casinos*. The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

Readers are encouraged to consult the full text of FASB ASC 606 on FASB's website at www.fasb.org.

The AICPA has formed 16 industry task forces to assist in developing a new Audit and Accounting Guide on revenue recognition that provides helpful hints and illustrative examples for how to apply the new standard (guide available at www.aicpastore.com). Revenue recognition implementation issues identified by the Gaming Revenue Recognition Task Force are available for informal comment, after review by the AICPA Financial Reporting Executive Committee (FinREC), at www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/rtrf-gaming.aspx.

Readers are encouraged to submit comments to revrecomments@aicpa.org.

As of the date of this publication, 11 accounting implementation issues specific to the gaming industry have been identified. Of the 11 identified issues, seven issues have been finalized and incorporated in the 2017 AICPA Audit and Accounting Guide *Revenue Recognition*. These finalized issues include the following:

- Assessment of Whether "Tier Status" in an Affinity Program Conveys a Material Right to Goods and Services and Therefore Gives Rise to a Separate Performance Obligation
- Definitions: The Terms "Win" and "Gross Gaming Revenue"
- Accounting for Jackpot Insurance Premiums and Recoveries
- Accounting for Gaming Chips and Tokens
- Net Gaming Revenue
- Gaming Operator's Accounting for Base Progressive and Incremental Progressive Jackpot Amounts
- Promotional Allowances

For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

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

¹ Terms that appear in the glossary are shown in *italics* the first time they appear. The glossary has not been cleared by GASB and thus is nonauthoritative.

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.

3.05 As explained in FASB 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/day (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, (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

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.

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 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 chips acquired at the table in exchange for 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 at shift changes 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 pay-offs 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	
	<hr/>	
Total drop		\$5,000
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)	
	<hr/>	
Total deductions before gross gaming revenue		(4,200)
Gross gaming revenue (Win)*		<hr/> <u>\$ 800</u>

* 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 exists to provide benefits based on a customer's past play (*nondiscretionary programs*). For other programs, there is discretion in determining the benefits provided, if any (*discretionary programs*). For discretionary programs, no pre-determined 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
- Whether the incentive is made generally available by other means absent a revenue transaction
- 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

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

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 or kiosk 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 nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB pronouncements that conflict with or contradict guidance provided in this chapter.

FASB Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers

The "Pending Content" that links to FASB ASC 606-10-65-1 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period, for a public business entity; a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market; and an employee benefit plan that files or furnishes financial statements with or to the SEC. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

For other entities, FASB ASC 606 is effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Other entities may elect to adopt the standard earlier, however, only as of either

- an annual reporting period beginning after December 15, 2016, including interim periods within that reporting period, or
- an annual reporting period beginning after December 15, 2016, and interim periods within annual periods beginning one year after the annual reporting period in which an entity first applies the "Pending Content" that links to FASB ASC 606-10-65-1.

FASB ASC 606 provides a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics, including FASB ASC 924, *Entertainment—Casinos*. The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

Readers are encouraged to consult the full text of FASB ASC 606 on FASB's website at www.aicpastore.com.

The AICPA has formed 16 industry task forces to assist in developing a new Audit and Accounting Guide on revenue recognition that provides helpful hints and illustrative examples for how to apply the new standard (guide available at www.aicpastore.com). Revenue recognition implementation issues identified by the Gaming Revenue Recognition Task Force

are available for informal comment, after review by the AICPA Financial Reporting Executive Committee (FinREC), at www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/rrtf-gaming.aspx.

Readers are encouraged to submit comments to revrecomments@aicpa.org.

As of the date of this publication, 11 accounting implementation issues specific to the gaming industry have been identified. Of the 11 identified issues, seven issues have been finalized and incorporated in the 2017 AICPA Audit and Accounting Guide *Revenue Recognition*. These finalized issues include the following:

- Assessment of Whether "Tier Status" in an Affinity Program Conveys a Material Right to Goods and Services and Therefore Gives Rise to a Separate Performance Obligation
- Definitions: The Terms "Win" and "Gross Gaming Revenue"
- Accounting for Jackpot Insurance Premiums and Recoveries
- Accounting for Gaming Chips and Tokens
- Net Gaming Revenue
- Gaming Operator's Accounting for Base Progressive and Incremental Progressive Jackpot Amounts
- Promotional Allowances

For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

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.

Summary of Selected Accounting Literature

4.02 FASB ASC 924 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 G, "Rules

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

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 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 typically follows 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 FASB ASC 924-605-25-2 states that "an entity shall accrue a liability and charge a base jackpot (or a portion thereof as applicable) to revenue at the

time the entity has the obligation to pay the jackpot regardless of the manner of payment." Therefore, an entity will not accrue a base jackpot if payments of the jackpot can be avoided.

4.09 For the incremental progressive amount, which is based on past play, FinREC 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 605. 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 nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB pronouncements that conflict with or contradict guidance provided in this chapter.*

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FASB ASC 606 provides a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics, including FASB ASC 924, *Entertainment—Casinos*. The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

Readers are encouraged to consult the full text of FASB ASC 606 on FASB's website at www.aicpastore.com.

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- Assessment of Whether "Tier Status" in an Affinity Program Conveys a Material Right to Goods and Services and Therefore Gives Rise to a Separate Performance Obligation
- Definitions: The Terms "Win" and "Gross Gaming Revenue"
- Accounting for Jackpot Insurance Premiums and Recoveries
- Accounting for Gaming Chips and Tokens
- Net Gaming Revenue
- Gaming Operator's Accounting for Base Progressive and Incremental Progressive Jackpot Amounts
- Promotional Allowances

For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

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.

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.

Summary of Selected Accounting Literature

5.04 The primary accounting guidance relating to participation and similar arrangements is described in FASB 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 when determining principal and agent considerations for the reporting of revenue and for entities subject to regulation by the SEC, *SEC Codification of Staff Accounting Bulletins*, topic 13, "Revenue Recognition." In addition, when applicable, the guidance described in FASB ASC 985, *Software*, should also be considered.

© Update 5-1 *Accounting and Reporting: Leases*

FASB ASU No. 2016-02, *Leases (Topic 842)*, issued in February 2016, is effective for fiscal years of a public business entity, a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and an employee benefit plan that files financial statements with the SEC beginning after December 15, 2018, including interim periods within those fiscal years.

For all other entities, FASB ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2019.

Early application is permitted for all entities.

FASB ASU No. 2016-02 supersedes the lease requirements in FASB ASC 840 and creates FASB ASC 842, *Leases*, to establish the principles that lessees and lessors should apply to report useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease. FASB ASC 842 affects any entity that enters into a lease (as that term is defined in FASB ASU No. 2016-02), with some specified scope exceptions.

Readers are encouraged to consult the full text of this ASU on FASB's website at www.fasb.org.

For more information on FASB ASU No. 2016-02, see appendix I, "The New Leases Standard: FASB ASU No. 2016-02," of this guide.

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 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 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 nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB pronouncements that conflict with or contradict guidance provided in this chapter.

FASB Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers

The "Pending Content" that links to FASB ASC 606-10-65-1 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period, for a public business entity; a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market; and an employee benefit plan that files or furnishes financial statements with or to the SEC. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

For other entities, FASB ASC 606 is effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Other entities may elect to adopt the standard earlier, however, only as of either

- an annual reporting period beginning after December 15, 2016, including interim periods within that reporting period, or
- an annual reporting period beginning after December 15, 2016, and interim periods within annual periods beginning one year after the annual reporting period in which an entity first applies the "Pending Content" that links to FASB ASC 606-10-65-1.

FASB ASC 606 provides a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics, including FASB ASC 924, *Entertainment—Casinos*. The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

Readers are encouraged to consult the full text of FASB ASC 606 on FASB's website at www.fasb.org.

The AICPA has formed 16 industry task forces to assist in developing a new Audit and Accounting Guide on revenue recognition that provides helpful hints and illustrative examples for how to apply the new standard (guide available at www.aicpastore.com). Revenue recognition implementation issues identified by the Gaming Revenue Recognition Task Force are

available for informal comment, after review by the AICPA Financial Reporting Executive Committee (FinREC), at www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/rtrtf-gaming.aspx.

Readers are encouraged to submit comments to revreccomments@aicpa.org.

As of the date of this publication, 11 accounting implementation issues specific to the gaming industry have been identified. Of the 11 identified issues, seven issues have been finalized and incorporated in the 2017 AICPA Audit and Accounting Guide *Revenue Recognition*. These finalized issues include the following:

- Assessment of Whether "Tier Status" in an Affinity Program Conveys a Material Right to Goods and Services and Therefore Gives Rise to a Separate Performance Obligation
- Definitions: The Terms "Win" and "Gross Gaming Revenue"
- Accounting for Jackpot Insurance Premiums and Recoveries
- Accounting for Gaming Chips and Tokens
- Net Gaming Revenue
- Gaming Operator's Accounting for Base Progressive and Incremental Progressive Jackpot Amounts
- Promotional Allowances

For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

Summary of Selected Accounting Literature

6.01 FASB, FinREC, 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. FASB ASC 605-50 explains the guidance in FASB ASC 605, 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; for entities subject to regulation by the SEC, the SEC *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 chapter 3 of this guide. Those incentives can generally be considered *discretionary*¹ or *nondiscretionary* (terms discussed further in the following text) for purposes of determining the proper accounting for each form of incentive.

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

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 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), complimentaries, 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 discretionary 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 is 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 complimentaries.

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,² or (b) the value of an individual award is significant compared with the purchase earning the award.

6.11 Under a deferred revenue model,³ 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.

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.⁴

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.

² 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 does not displace themselves as a paying customer for purposes of applying the guidance in this guide.

³ See FASB *Accounting Standards Codification* 605-50-25-4 for a discussion regarding the recognition of a liability (or *deferred revenue*).

⁴ 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, when the consideration consists of a free product or service, or anything other than cash or equity instruments, the cost of the consideration should be characterized 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 by applying the expected payout percentage, net of expected breakage using the amount of free play that is 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, resulting in \$0 net gaming revenue for the period of redemption (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, resulting in \$6 of net gaming revenue for the period of redemption (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,⁵ 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 revenue/cost accrual models have been used to account for complimentaries offered through nondiscretionary loyalty programs.

6.23 When the immediate revenue/cost accrual model is used, FinREC believes that costs of complimentaries 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 complimentaries owed is that to the extent that a customer is entitled to those complimentaries, 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 complimentaries, 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 complimentaries. Further, assume the gaming entity's average hold percentage is 7 percent. Further assume that the gaming entity determined

⁵ Breakage from nondiscretionary loyalty programs is not typically considered to be abandoned property, and escheat laws are generally inapplicable to such programs.

that the incremental cost of \$100 of complimentary 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, 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). The revenue and gaming expense are ultimately "eliminated" in the gaming entity's financial statements. As discussed in chapter 4, "Jackpot Liabilities," no revenue is reported as a result of providing complimentary.

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 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, and in the period of redemption, resulting in \$99 of net gaming revenue for the period of redemption (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.

	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 ¹	— ²	700	601	99 ³	700

¹ Also recognize gaming department expense of \$30 for the estimated cost of providing the complimentary goods or services.

² 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."

³ Also recognize the actual cost of providing the complimentary goods or services.

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, complimentary, 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. Typically, cash incentives have the highest cost to the gaming entity, followed by free play, and then complimentary, assuming the face amount of the incentives are equal. 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, complimentary, or other economic benefits, though that status may lead to complimentary 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 the notes to the financial statements in accordance with FASB ASC 235-10-50. Typical information provided by gaming entities include the nature of the programs, whether an immediate 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 nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB 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 FASB *Accounting Standards Codification* (ASC) 350, *Intangibles—Goodwill and Other*. The likelihood concepts 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 are expensed in accordance with other existing guidance as described throughout FASB ASC. For example, 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. 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. 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). Under the requirements of FASB ASC 350-30, accounting for a recognized intangible asset is based on its useful life to the reporting entity. An intangible asset with a finite useful life should be amortized; an intangible asset with an indefinite useful life should not be amortized.

7.09 FASB ASC 350-30-35-6 states that, if an intangible asset has a finite useful life, but the precise length of that life is not known, that intangible asset should be amortized over the best estimate of its useful life. The method of amortization should 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 is to be used.

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.

7.10 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 not subject to amortization should be tested for impairment annually and more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired. An intangible asset with an indefinite useful life should be tested for impairment in accordance with paragraphs 18–19 of FASB ASC 350-30-35. An entity may first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that an indefinite-lived intangible asset is impaired. Paragraphs 18B–18C of FASB ASC 350-30-35 include examples of relevant events and circumstances that could affect the significant inputs used to determine the fair value of an indefinite-lived intangible asset. If, after assessing the totality of events and circumstances and their potential effect on significant inputs to the fair value determination, the entity determines that it is more likely than not that the indefinite-lived intangible asset is impaired, the entity performs the quantitative impairment test in FASB ASC 350-30-35-19 to measure the impairment. The quantitative impairment test is a comparison of the fair value of the intangible asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an impairment loss should be recognized in an amount equal to that excess.

7.11 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

7.12 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). A gaming entity may also incur these types of costs in connection with a significant expansion of an existing facility. 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.

7.13 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

7.14 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
- 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

7.15 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 nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB pronouncements that conflict with or contradict guidance provided in this chapter.

FASB Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers

The "Pending Content" that links to FASB ASC 606-10-65-1 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period, for a public business entity; a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market; and an employee benefit plan that files or furnishes financial statements with or to the SEC. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

For other entities, FASB ASC 606 is effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Other entities may elect to adopt the standard earlier, however, only as of either

- an annual reporting period beginning after December 15, 2016, including interim periods within that reporting period, or
- an annual reporting period beginning after December 15, 2016, and interim periods within annual periods beginning one year after the annual reporting period in which an entity first applies the "Pending Content" that links to FASB ASC 606-10-65-1.

FASB ASC 606 provides a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics, including FASB ASC 924, *Entertainment—Casinos*. The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

Readers are encouraged to consult the full text of FASB ASC 606 on FASB's website at www.fasb.org.

The AICPA has formed 16 industry task forces to assist in developing a new Audit and Accounting Guide on revenue recognition that provides helpful hints and illustrative examples for how to apply the new standard (guide available at www.aicpastore.com). Revenue recognition implementation issues identified by the Gaming Revenue Recognition Task Force are

available for informal comment, after review by the AICPA Financial Reporting Executive Committee (FinREC), at www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/rrtf-gaming.aspx.

Readers are encouraged to submit comments to revrecomments@aicpa.org.

As of the date of this publication, 11 accounting implementation issues specific to the gaming industry have been identified. Of the 11 identified issues, seven issues have been finalized and incorporated in the 2017 AICPA Audit and Accounting Guide *Revenue Recognition*. These finalized issues include the following:

- Assessment of Whether "Tier Status" in an Affinity Program Conveys a Material Right to Goods and Services and Therefore Gives Rise to a Separate Performance Obligation
- Definitions: The Terms "Win" and "Gross Gaming Revenue"
- Accounting for Jackpot Insurance Premiums and Recoveries
- Accounting for Gaming Chips and Tokens
- Net Gaming Revenue
- Gaming Operator's Accounting for Base Progressive and Incremental Progressive Jackpot Amounts
- Promotional Allowances

For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

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,

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

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 FASB 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 as it relates to amounts contingent on future earnings; and FASB ASC 605.

8.06 FinREC 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.

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.

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.

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 records \$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.

⁴ See footnote 3.

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 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 records \$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 \$100 of management fee expense is reclassified to utility expense by the Managed Property.

8.19 Amounts remitted to the Managed Property by the gaming entity are 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

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

- 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 referred to in paragraph 8.20:

In September 20X1, 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, 20X3, gaming entity recognized \$1,500,000 of revenue and \$800,000 of expenses in connection with the agreement. At December 31, 20X3, gaming entity had a \$250,000 receivable from Managed Property. Payment of this balance was received in January 20X4.

Chapter 9

Guarantees

Applicability: This chapter provides guidance applicable to nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB pronouncements that conflict with or contradict guidance provided in this chapter.

FASB Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers

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FASB ASC 606 provides a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics, including FASB ASC 924, *Entertainment—Casinos*. The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

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As of the date of this publication, 11 accounting implementation issues specific to the gaming industry have been identified. Of the 11 identified issues, seven issues have been finalized and incorporated in the 2017 AICPA Audit and Accounting Guide *Revenue Recognition*. These finalized issues include the following:

- Assessment of Whether "Tier Status" in an Affinity Program Conveys a Material Right to Goods and Services and Therefore Gives Rise to a Separate Performance Obligation
- Definitions: The Terms "Win" and "Gross Gaming Revenue"
- Accounting for Jackpot Insurance Premiums and Recoveries
- Accounting for Gaming Chips and Tokens
- Net Gaming Revenue
- Gaming Operator's Accounting for Base Progressive and Incremental Progressive Jackpot Amounts
- Promotional Allowances

For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

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 FASB ASC 460, *Guarantees*, is the primary accounting guidance for guarantees. In accordance with FASB ASC 460, the guarantor recognizes 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 arrangements; and FASB ASC 605-50 regarding customer payments and incentives, all explained in FASB ASC 605. Readers may also refer to the illustrative guidance presented in appendix D, "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:

- If 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 be the premium received or receivable by the guarantor as a practical expedient.
- If 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. In that circumstance, a guarantor should 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 as a practical expedient.

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 in a orderly transaction between market participants 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. 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 fair value of the guarantee should be determined.

9.08 The estimated fair value of the guarantee is recorded in the manager's statement of financial position as a liability.

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.

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 460-10-25-4 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 FinREC 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 is not 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 allocated to the guarantee pursuant to a FASB ASC 605-25 model, while reporting no receivable for the portion of the overall management fee 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 should 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 is typically 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) is appropriate includes 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 is typically 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, and disclosed by the manager.

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, results 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 should 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 should 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. FinREC believes that although other amortization methods may be utilized, 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 in accordance with 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.

The scope of FASB ASC 810 may be applicable to circumstances in which gaming entities manage and guarantee the debt of other entities undertaking gaming activities.

Chapter 10

Long-Lived Assets

Applicability: *This chapter provides guidance applicable to nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB 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 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. FASB ASC 360 provides guidance for a long-lived asset (asset group) held and used and 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. 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 FASB 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.

10.16 Circumstances may exist, however, in which the facility housing the gaming activities is not the primary asset. For example, a cruise ship may include a relatively small casino area. In these circumstances, the entire cruise ship, rather than the casino area, is typically 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.

10.17 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 included within the asset group at the date at which the primary asset is 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.¹ 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.

10.18 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).

10.19 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.

10.20 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 Obligations

10.21 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. However, not all obligations are

¹ As stated in FASB *Accounting Standards Codification* (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 described in FASB ASC 250, *Accounting Changes and Error Corrections*, or the amortization period as described in FASB ASC 350, *Intangibles—Goodwill and Others*.

considered asset retirement obligations, and readers should refer to guidance in FASB ASC 410-20-15-3. Some examples of those obligations are as follows:

- 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.
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Chapter 11

Other Accounting Topics

Applicability: This chapter provides guidance applicable to nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB pronouncements that conflict with or contradict guidance provided in this chapter.

FASB Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers

The "Pending Content" that links to FASB ASC 606-10-65-1 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period, for a public business entity; a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market; and an employee benefit plan that files or furnishes financial statements with or to the SEC. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

For other entities, FASB ASC 606 is effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Other entities may elect to adopt the standard earlier, however, only as of either

- an annual reporting period beginning after December 15, 2016, including interim periods within that reporting period, or
- an annual reporting period beginning after December 15, 2016, and interim periods within annual periods beginning one year after the annual reporting period in which an entity first applies the "Pending Content" that links to FASB ASC 606-10-65-1.

FASB ASC 606 provides a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics, including FASB ASC 924, *Entertainment—Casinos*. The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

Readers are encouraged to consult the full text of FASB ASC 606 on FASB's website at www.fasb.org.

The AICPA has formed 16 industry task forces to assist in developing a new Audit and Accounting Guide on revenue recognition that provides helpful hints and illustrative examples for how to apply the new standard (guide available at www.aicpastore.com). Revenue recognition implementation issues identified by the Gaming Revenue Recognition Task Force are

available for informal comment, after review by the AICPA Financial Reporting Executive Committee (FinREC), at www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/rrtf-gaming.aspx.

Readers are encouraged to submit comments to revrecomments@aicpa.org.

As of the date of this publication, 11 accounting implementation issues specific to the gaming industry have been identified. Of the 11 identified issues, seven issues have been finalized and incorporated in the 2017 AICPA Audit and Accounting Guide *Revenue Recognition*. These finalized issues include the following:

- Assessment of Whether "Tier Status" in an Affinity Program Conveys a Material Right to Goods and Services and Therefore Gives Rise to a Separate Performance Obligation
- Definitions: The Terms "Win" and "Gross Gaming Revenue"
- Accounting for Jackpot Insurance Premiums and Recoveries
- Accounting for Gaming Chips and Tokens
- Net Gaming Revenue
- Gaming Operator's Accounting for Base Progressive and Incremental Progressive Jackpot Amounts
- Promotional Allowances

For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

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 FASB ASC 350, *Intangibles—Goodwill and Other*, for recognition as an asset apart from goodwill.¹ 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 a finite life or is indefinite lived. Although a gaming entity should perform a detailed review of the criteria in FASB ASC 350,² 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 Pre-opening 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.

¹ FASB *Accounting Standards Codification* (ASC) 805, *Business Combinations*, provides an accounting alternative that a qualifying entity may elect regarding intangible assets acquired in a business combination. See FASB ASC for additional information.

² For additional guidance, refer to FASB ASC 350-30 to assist in determining the useful life of intangible assets.

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:

- 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.³

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.

³ Promotional payouts not associated with gaming activities are not included in the discussion in this chapter.

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.

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, in accordance with FASB ASC 924-405-35-1, the chip liability should 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*⁴), 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 in the FASB ASC glossary. The offsetting entry for the reduction in the chips and tokens liability is recorded as a component of net gaming revenue.⁵

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

⁴ Terms that appear in the glossary are shown in *italics* the first time they appear.

⁵ 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 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.

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.

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.

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, should 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 pre-established 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 authoritative guidance in this chapter. The guidance in this chapter does not apply to nongovernmental gaming entities. Chapter 3, "Overview of Gaming and Gaming Related Revenue" of this guide also includes category B generally accepted accounting principles for governmental entities.

Unless it conflicts with or contradicts GASB pronouncements, governmental gaming entities may also consider the guidance in chapters 4–11, appendixes C–F, and the glossary as nonauthoritative accounting literature set forth in paragraphs 6–8 of GASB Statement No. 76, *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.

GAAP Hierarchy for Governmental Gaming Entities

12.02 GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, defines the sources of accounting principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP, and the framework for selecting those principles. GASB Statement No. 76 categorizes the sources of authoritative GAAP, in descending order of authority, as follows:

- a. Category A: Officially established accounting principles—GASB statements¹
- b. Category B: GASB Technical Bulletins, GASB Implementation Guides, and literature of the AICPA specifically cleared by GASB²

12.03 Under GASB Statement No. 76, if the accounting treatment for a transaction or other event is not specified by a pronouncement in category A, a governmental gaming entity should consider whether the accounting treatment is specified by an accounting principle from a source in category B. In such

¹ All GASB Interpretations previously issued and currently in effect also are included in category A of generally accepted accounting principles (GAAP) until altered, amended, supplemented, revoked, or superseded by subsequent GASB pronouncements.

² The provisions of this guide that are category B accounting and financial reporting guidance for state and local governmental entities appear in orange font within the text of the guide and are noted in appendix A, "Category B Guidance."

cases, if category B contains an accounting principle that specifies the accounting treatment for a transaction or other event, the governmental entity should follow the accounting treatment specified by that accounting principle. If the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP sources, a governmental entity should consider accounting principles for similar transactions or other events within category A or category B and then may consider nonauthoritative accounting literature.

12.04 As governmental gaming entities and their auditors consider the applicability of private-sector standards discussed in the other chapters of this guide, the appropriateness of nonauthoritative accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. A governmental entity should not follow the accounting treatment specified in accounting principles for similar transactions or other events in cases in which those accounting principles either prohibit the application of the accounting treatment to the particular transaction or other event or indicate that the accounting treatment should not be applied by analogy.

Summary of Selected Accounting Literature

12.05 The primary sources of guidance in this chapter that are applicable to governmental entities are³

- GASB Statement No. 14, *The Financial Reporting Entity*, as amended,
- GASB Statement No. 34, *Basic Financial Statements— and Management's Discussion and Analysis— State and Local Governments*, as amended,
- GASB Statement No. 37, *Basic Financial Statements— and Management's Discussion and Analysis— State and Local Governments: Omnibus*, as amended,
- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, as amended,
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus— an amendment of GASB Statements No. 14 and No. 34*, as amended,
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, as amended,
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*,
- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*,
- GASB Statement No. 72, *Fair Value Measurement and Application*, as amended, and

³ For additional information regarding GASB Statements readers are advised to refer to the AICPA Audit and Accounting Guide *State and Local Governments*. The auditing guidance in that guide should also be considered during an audit of a governmental gaming entity that is included in the scope of this guide.

- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

Basic Financial Statements and Required Supplementary Information

12.06 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.

12.07 Accounting and financial reporting for separately issued GAAP-based financial statements for one or more individual funds are not currently addressed by GASB standards.⁴ 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.

12.08 GASB Statement No. 63 provides guidance for reporting deferred⁵ outflows of resources and deferred inflows of resources in a statement of financial position. Deferred outflows of resources and deferred inflows of resources are transactions that result in the consumption or acquisition of net assets in one period that are applicable to a future period. The change in fair value of hedging derivatives, such as interest rate swap agreements that are commonly entered into by governmental gaming entities and their sponsoring governments, are among the items identified by GASB as deferred outflows of resources and deferred inflows of resources.

12.09 GASB Statement No. 63 provides that the statement of net position should report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Governments are encouraged to present the statement of net position in a format that displays assets, plus deferred outflows of resources, less liabilities, less deferred inflows of resources, equals net position, although a balance sheet format (assets plus deferred outflows of resources equals liabilities plus deferred inflows of resources, plus net position) may be used. Regardless of the format, the statement of net position should report the residual amount as net position, rather than net assets or equity. Net position represents the difference between all other elements in a statement of financial position and should be displayed in three components—net investment in capital assets, restricted (distinguishing between major categories of restrictions), and unrestricted.

12.10 All changes in net position of governmental gaming entities, including distributions to and contributions from the sponsoring government, are

⁴ Accordingly, GASB did not clear provisions set forth in this paragraph.

⁵ GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, specifies that use of the term *deferred* should be limited to items reported as deferred outflows of resources or deferred inflows of resources.

reported in the statement of revenues, expenses, and changes in net position. Because the statement of revenues, expenses, and changes in net position is all inclusive, the governmental financial reporting model does not include a separate statement of changes in stockholders equity as a basic financial statement.

12.11 Governmental gaming entities are typically engaged only in business-type activities and use a single column for financial statement presentation. In this scenario, a component unit of that governmental entity that meets the criteria for blending may be included by consolidating its financial statement data within the single column and presenting condensed combining information in the notes to the financial statements. Paragraph 54a of GASB Statement No. 14, as amended, provides the minimum presentation for the condensed combining information. Additional guidance related to the financial reporting entity concept for governmental entities can be found in chapter 3, "The Financial Reporting Entity," of the Audit and Accounting Guide *State and Local Governments*.

12.12 Paragraph 55 of GASB Statement No. 14, as amended, addresses the reporting of equity interests in legally separate organizations. If a governmental gaming entity owns a majority of the equity interest in a legally separate organization (for example, through acquisition of its voting stock), the governmental entity's intent for owning the equity interest should determine whether the organization should be presented as a component unit or an investment of the governmental entity. If the governmental entity's intent for owning a majority equity interest is to directly enhance its ability to provide governmental services, the organization should be reported as a component unit. When a component unit is discretely presented, an equity interest should be reported as an asset of the fund that has the equity interest (subject to reporting requirements for governmental funds) and that changes in the equity interest should be reported using the equity method of accounting. These provisions apply to governmental gaming entities that have discretely presented component units, as well as governmental entities that report gaming entities as discretely presented component units. If, however, the government owns the equity interest as an investment (as defined in GASB Statement No. 72) rather than to directly enhance its ability to provide governmental services, it should report its equity interest as an investment regardless of the extent of its ownership. An investment is defined in paragraph 64 of GASB Statement No. 72 as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash.⁶

Resource Flows Between Governmental Gaming Entities and Sponsoring Governments

12.13 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

⁶ Chapter 5, "Investments, Certain Equity Interests, and Derivatives" of the AICPA Audit and Accounting Guide *State and Local Governments* provides additional discussion of accounting and auditing considerations.

- Contribution of capital assets to or from the primary government (capital contributions)
- 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

12.14 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,⁷ whereas gaming entities that are discretely presented component units report such resource flows as nonoperating revenues and expenses.

12.15 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

12.16 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.⁸ 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.

⁷ See paragraph 112 of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—State and Local Governments*, as amended, 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.

⁸ See paragraph 42 of the National Council on Governmental Accounting Statement No. 1, *Governmental Accounting and Financial Reporting Principles*.

Impairment of Capital Assets

12.17 GASB Statement No. 42, as amended, 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.

12.18 GASB Statement No. 42, as amended, 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

12.19 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

12.20 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

12.21 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

12.22 Segment reporting applicable to governmental entities specified by paragraphs 122–123 of GASB Statement No. 34, as amended, 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

Gray shaded text in this chapter reflects guidance issued but not yet effective as of the date of this guide, September 1, 2017, but becoming effective on or prior to December 31, 2017, exclusive of any option to early adopt ahead of the mandatory effective date. Unless otherwise indicated, all unshaded text reflects guidance that was already effective as of the date of this guide.

Introduction²

13.01 This chapter provides guidance for performing audits of entities that undertake gaming and gaming related activities whose audits often involve unique and complex matters and includes guidance on the application of the auditor's overall objectives, including the risk assessment process and general auditing considerations.

13.02 This chapter 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. The types of controls required and the audit procedures performed by the 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, assessment of the materiality of account balances and individual transactions in relation to the financial statements as a whole, and the risks of material misstatement, whether due from fraud or error.

13.03 AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*), addresses the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with generally accepted auditing standards (GAAS). Specifically, it sets out the overall objectives of the independent auditor (the auditor) and explains the nature and scope of an audit designed to enable the auditor to meet those objectives. It also explains the scope, authority, and structure of GAAS and includes requirements establishing the general responsibilities of the auditor applicable in all audits, including the obligation to comply with GAAS.

¹ Gaming entities may be required by statute or other mandates, or voluntarily elect, 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. The AICPA Audit Guide *Government Auditing Standards and Single Audits* discusses *Government Auditing Standards* requirements and guidance related to financial audits. A practice aid, *2011 Yellow Book Independence—Non-Audit Services Documentation Practice Aid*, has been developed by the AICPA Governmental Audit Quality Center (GAQC) to assist an auditor in evaluating nonaudit services and the effect of performing such services on auditor independence under the 2011 revision. More information about the practice aid and how to obtain it can be found on the Resources page of the GAQC website at www.aicpa.org/gaqc.

² Auditors should refer to the AICPA Audit and Accounting Guide *State and Local Governments*, for additional information regarding audits of governmental entities.

13.04 Paragraph .12 of AU-C section 200 states that the overall objectives of the auditor when conducting an audit of financial statements are to

- a. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework; and
- b. report on the financial statements, and communicate as required by GAAS, in accordance with the auditor's findings.

Terms of Engagement

13.05 AU-C section 210, *Terms of Engagement* (AICPA, *Professional Standards*), addresses the auditor's responsibilities in agreeing upon the terms of the audit engagement with management and, when appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, for which management and, when appropriate, those charged with governance are responsible, are present. AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*), addresses those aspects of engagement acceptance that are within the control of the auditor.

13.06 Paragraphs .06–.08 of AU-C section 210 establish the auditor's responsibility in determining whether the preconditions for an audit are present, and to determine if there are any limitations on the scope of the auditor's work in the terms of a proposed audit engagement.

13.07 Examples of some industry-specific factors the auditor may consider prior to agreeing to perform an audit of an existing gaming entity are as follows:

- Recent results of gaming regulatory examinations (for all jurisdictions).
- The entity's compliance with federal currency transaction reporting and anti-money laundering regulations (for all jurisdictions).
- The auditor's knowledge and experience with the industry, including familiarity with the regulatory structure, as well as required regulatory procedures to be performed.
- Gaming regulations, which require the auditor to
 - in certain jurisdictions be licensed as a CPA in the state where the gaming entity is located, or be registered as an approved vendor with the regulatory body, or both.
 - provide gaming regulators access to audit documentation.
 - comply with audit documentation retention policies.
- 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 effect on the auditor's ability to satisfy himself regarding various cash balances as well as gaming liabilities that existed at year end.
- The auditor's ability to perform required internal control testing for regulatory and other reporting purposes, including gaining an understanding of the entity's internal control.

13.08 The scope of services rendered by auditors generally depends on the types of reports to be issued as a result of the engagement. Paragraphs .09–.10 of AU-C section 210 state that the auditor should agree upon the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the audit engagement should be documented in an audit engagement letter or other suitable form of written agreement (see paragraph .10 of AU-C section 210 for a listing of agreed-upon terms that should be included). Both management and the auditor have an interest in documenting the agreed-upon terms of the audit engagement before the commencement of the audit to help avoid misunderstandings with respect to the audit as stated in paragraph .A22 of AU-C section 210.

13.09 In accordance with paragraphs .A23–.A24 of AU-C section 210, the form and content of the audit engagement letter may vary for each entity. When relevant, additional services to be provided, such as those relating to regulatory requirements, could be referenced to in the audit engagement letter.

13.10 Paragraph .11 of AU-C section 210 states that before accepting an engagement for an initial audit, including a reaudit engagement, the auditor should request management to authorize the predecessor auditor to respond fully to the auditor's inquiries regarding matters that will assist the auditor in determining whether to accept the engagement. If management refuses to authorize the predecessor auditor to respond, or limits the response, the auditor should inquire about the reasons and consider the implications of that refusal in deciding whether to accept the engagement.

Opening Balances—Initial Audit Engagements, Including Reaudit Engagements

13.11 Paragraph .01 of AU-C section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements* (AICPA, *Professional Standards*), addresses the auditor's responsibilities relating to opening balances in an initial audit engagement, including a reaudit engagement. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. For initial audit engagements the following are examples of gaming-specific areas generally affecting the opening balances of gaming entities or entities with gaming related activities:

- 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*³ and *unpays*

An Audit of Financial Statements

13.12 Consistent with the guidance presented in paragraph .04 of AU-C section 200, the purpose of an audit of the gaming entity's financial statements is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework. An audit conducted in accordance with GAAS and relevant ethical requirements enables the auditor to form that opinion. As the basis for the auditor's opinion, paragraph .06 of AU-C section 200 states that GAAS require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce *audit risk* (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.

13.13 Paragraphs .08 and .10 of AU-C section 200 state that GAAS contain objectives, requirements, and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. GAAS require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things,

- identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
- obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- form an opinion on the financial statements, or determine that an opinion cannot be formed, based on an evaluation of the audit evidence obtained.

The auditor also may have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, regarding matters arising from the audit. These responsibilities may be established by GAAS or by applicable law or regulation.

Planning the Audit

13.14 AU-C section 300, *Planning an Audit* (AICPA, *Professional Standards*), addresses the auditor's responsibilities to plan an audit of financial statements. AU-C section 300 is written in the context of recurring audits. Matters related to planning audits of group financial statements are addressed in AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (AICPA, *Professional Standards*). Planning an audit involves establishing the overall audit strategy for

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

the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

- Helping the auditor identify and devote appropriate attention to important areas of the audit
- Helping the auditor identify and resolve potential problems on a timely basis
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and allocating team member responsibilities
- Facilitating the direction and supervision of engagement team members and the review of their work
- Assisting, when applicable, in coordination of work done by auditors of components and specialists

Paragraph .A1 of AU-C section 200 further explains that the nature and extent of planning activities will vary according to the size and complexity of the entity, the key engagement team members' previous experience with the entity, and changes in circumstances that occur during the audit engagement.

13.15 In accordance with paragraph .09 of AU-C section 300, the auditor should develop an audit plan that includes a description of the nature and extent of planned risk assessment procedures, as determined under AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*); the nature, timing, and extent of planned further audit procedures at the relevant assertion level, as determined under AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AICPA, *Professional Standards*); and other planned audit procedures that are required to be carried out so that the engagement complies with GAAS. Paragraph .A2 of AU-C section 300 explains that planning is not a discrete phase of the audit, but rather a continual iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.

13.16 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. The auditor may consider providing training programs and briefing sessions.
- Visiting and performing inspections and testing of the client's remote marketing offices and agents that hold cash and original receivable documents.
- 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 the internal audit function.

- 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

13.17 Paragraph .A36 of AU-C section 200 explains that audit risk is a function of the risks of material misstatement and detection risk. The assessment of risk is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

13.18 Paragraphs .A38–.A40 of AU-C section 200 provide further explanation on the two levels of the risks of material misstatement. The risks of material misstatement exist at the overall financial statement level and the assertion level for classes of transactions, account balances, and disclosures. Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

13.19 The auditor should design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level as described in paragraph .06 of AU-C section 330.

13.20 Paragraph .A108 of AU-C section 315 describes risks of material misstatement at the financial statement level as risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level (for example, through management override of internal control). Financial statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud.

13.21 Paragraph .07 of AU-C section 330 provides guidance for the auditor in designing the further audit procedures to be performed. It states that the auditor should consider the reasons for the assessed risk of material misstatement at the relevant assertion level for each class of transactions, account balance, and disclosure, including the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (the inherent risk); and whether the risk assessment takes account of relevant controls (the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures).

The auditor should obtain more persuasive audit evidence the higher the auditor's assessment of risk.

13.22 The following is a list of some inherent risk factors 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

Use of Assertions in Obtaining Audit Evidence in the Assessment of Risks of Material Misstatement

13.23 Paragraphs .A113–.A118 of AU-C section 315 discuss the use of assertions in the assessment of risks of material misstatement. In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, and disclosure of the various elements of financial statements and related disclosures. Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following categories and may take the following forms.

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.

(continued)

	<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>
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.

13.24 According to paragraphs .26–.27 of AU-C section 315, the auditor should use relevant assertions for classes of transactions, account balances, 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 relating the identified risks to what can go wrong at the relevant assertion level, taking account of relevant controls that the auditor intends to test, and designing further audit procedures that are responsive to the assessed risks.

Materiality⁴

13.25 The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of financial statements. The concept of materiality is applied by the auditor both in planning and performing the audit; evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements; and in forming the opinion in the auditor's report.

⁴ Chapter 4 of the AICPA's Audit and Accounting Guide *State and Local Governments* contains guidance on materiality as it relates to governmental entities.

13.26 AU-C section 320, *Materiality in Planning and Performing an Audit* (AICPA, *Professional Standards*), addresses the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. AU-C section 450, *Evaluation of Misstatements Identified During the Audit* (AICPA, *Professional Standards*), explains how materiality is applied in evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements.

13.27 When establishing the overall audit strategy, paragraph .10 of AU-C section 320 states that the auditor should determine a materiality level for the financial statements as a whole. If, in the specific circumstances of the entity, one or more particular classes of transactions, account balances, or disclosures exist for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users, then, taken on the basis of the financial statements, the auditor also should determine the materiality level or levels to be applied to those particular classes of transactions, account balances, or disclosures.

13.28 Paragraph .A14 of AU-C section 320 explains that planning the audit solely to detect individual material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and leaves no margin for possible undetected misstatements. Therefore, in accordance with paragraph .11 of AU-C section 320, the auditor should determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing, and extent of further audit procedures. *Performance materiality*, for purposes of GAAS, is defined in AU-C section 320 as the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances, or disclosures. Performance materiality is to be distinguished from tolerable misstatement, which is the application of performance materiality to a particular sampling procedure.⁵

13.29 Paragraph .A14 of AU-C section 320 continues to explain that the determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures, and the nature and extent of misstatements identified in previous audits and, thereby, the auditor's expectations regarding misstatements in the current period.

13.30 As indicated previously, the determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. As a result, a relatively small amount that comes 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).

⁵ AU-C section 530, *Audit Sampling* (AICPA, *Professional Standards*), defines tolerable misstatement and provides further application guidance about the concept.

13.31 Paragraph .06 of AU-C section 320 notes that although it is not practicable to design audit procedures to detect misstatements that could be material solely because of their nature (that is qualitative considerations), the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements.

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

13.32 Paragraph .01 of AU-C section 315 addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements through understanding the entity and its environment, including the entity's internal control. The objective of the auditor is to identify the risks of material misstatement, whether due to error or fraud, at the financial statement and relevant assertion levels through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

13.33 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-C section 240, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*). For additional guidance pertaining to AU-C section 240, see paragraphs 13.73–.111 in this chapter.

13.34 The following considerations may be helpful for the auditor in developing the required understanding of the gaming industry, the entity, its environment, and its internal control, and in identifying the risks of material misstatement:

- Experience has shown that a greater possibility of fraud exists in operations in which large amounts of cash are being handled.
- Because of the number of regulations and regulatory reporting requirements that a gaming entity is subject to, the auditor may benefit from gaining an understanding of, and familiarity with, such regulations and reporting requirements before the audit starts.
- Inquiry about any regulatory investigations, the stage of any such investigation, and management's and counsel's expectations of the outcome of such investigations made early in the audit may assist the auditor in properly planning the audit.
- Regulations require many gaming entities to have internal audit functions. The type of work performed by 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.⁶

⁶ See paragraph 13.144 for information on AU-C section 610, *Using the Work of Internal Auditors* (AICPA, *Professional Standards*).

13.35 In accordance with paragraph .A3 of AU-C section 315, the auditor is required to exercise professional judgment to determine the extent of the understanding required of the entity. The auditor's primary consideration is whether the understanding that has been obtained is sufficient to meet the objectives of AU-C section 315. The depth of the overall understanding that is required by the auditor is less than that possessed by management in managing the entity.

13.36 Paragraph .12 of AU-C section 315 describes the auditor's understanding of the entity and its environment. The auditor's understanding of the entity consists of an understanding of the following aspects relating to the entity:

- a. Industry, regulatory, and other external factors including the entity's applicable financial reporting framework.
- 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. The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor should evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
- e. Measurement and review of the entity's financial performance.

Appendix A, "Understanding the Entity and Its Environment," of AU-C section 315 provides examples of matters that the auditor may consider in obtaining an understanding of the entity and its environment relating to the preceding categories.

13.37 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 along with an understanding of the operating segments of the business, as defined by FASB *Accounting Standards Codification* (ASC) 280-10-50.

13.38 An understanding of the gaming 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
- Reading market analysts reports and news articles regarding specific markets in which the casino operates
- Understanding regulatory, legal and operating requirements that may restrict the gaming entity's operations

Discussion Among the Audit Team

13.39 In obtaining an understanding of the entity and its environment, paragraph .11 of AU-C section 315 states that the engagement partner and other key engagement team members should discuss the susceptibility of the entity's financial statements to material misstatements and the application of the applicable financial reporting framework to the entity's facts and circumstances. The engagement partner should determine which matters are to be communicated to engagement team members not involved in the discussion. This discussion may be held concurrently with the discussion among the audit team that is specified by AU-C section 240 to discuss the susceptibility of the entity's financial statements to fraud.

Industry Risk Factors

13.40 It may be useful for auditors with clients in the gaming industry to 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 13.81–.85 in this chapter. Appendix F, "Currency Transaction Reporting in the Gaming Industry," of this guide 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 may want to consider obtaining an understanding of such risk factors when planning the audit of a gaming entity or entity with gaming related activities.

Related Parties

13.41 Obtaining an understanding of a client's business should also include performing the procedures in AU-C section 550, *Related Parties* (AICPA, *Professional Standards*), to determine the existence of related-party relationships and transactions with such parties.

13.42 Paragraph .03 of AU-C section 550 states that many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give

rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example

- related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- related party transactions may not be conducted under normal market terms and conditions (for example, some related party transactions may be conducted with no exchange of consideration).
- related party transactions may be motivated solely or in large measure to engage in fraudulent financial reporting or conceal misappropriation of assets.
- on occasion entities may try to create various legal structures to bypass licensure requirements. For example, the nonregulated portion of the entity's business may reside on one legal structure while the regulated gaming portion may reside in another legal structure. Legal ownership for both entities may differ but these entities may be related parties based upon their dependency on each other.

Responsibilities of the Auditor

13.43 As described in paragraph .04 of AU-C section 550, because related parties are not independent of each other, financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions, and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. Therefore, the auditor has a responsibility to perform audit procedures to identify, assess, and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions, or balances.

13.44 In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present, as required by AU-C section 240. This is because fraud may be more easily committed through related party relationships.⁷

Risk Assessment Procedures

13.45 Paragraph .04 of AU-C section 315 defines *risk assessment procedures* as audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error at the

⁷ FASB *Accounting Standards Codification* 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.

financial statement and relevant assertion levels. The results of the risk assessment procedures provide the basis for designing further audit procedures, that is, tests of controls, substantive tests of details, substantive analytical procedures, or a combination of those procedures. Paragraph .05 of AU-C section 315 states that the auditor should perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatements 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.

13.46 According to paragraph .A2 of AU-C section 315, information obtained by performing related activities may be used by the auditor as audit evidence to support assessments of the risks of material misstatement. In addition, the auditor may obtain audit evidence about classes of transactions, account balances, or disclosures and relevant assertions about the operating effectiveness of controls, even though such audit procedures were not specifically planned as substantive procedures or as tests of controls concurrently with risk assessment procedures because it is efficient to do so.

13.47 In accordance with paragraph .06 of AU-C section 315, the risk assessment procedures should include the following:

- a. Inquiries of management and others within the entity who, in the auditor's professional judgment, may have information that is likely to assist in identifying risks of material misstatement due to fraud or error
- b. Analytical procedures
- c. Observation and inspection

See paragraphs .A6–.A11 of AU-C section 315 for additional guidance on risk assessment procedures.

Designing and Performing Further Audit Procedures

13.48 This section provides guidance on assessing the risks of material misstatement and how to design further audit procedures that effectively respond to those risks.

13.49 To provide a basis for designing and performing further audit procedures, paragraphs .26–.27 of AU-C section 315 state that the auditor should identify and assess the risks of material misstatement at the financial statement level and at the relevant assertion level for 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, by considering the classes of transactions, account balances, and disclosures in the financial statements.
- b. assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions.
- c. relate the identified risks to what can go wrong at the relevant assertion level, taking account of relevant controls that the auditor intends to test.

- d. consider the likelihood that misstatement including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

13.50 When assessing risks as it relates to the use of accounting estimates, the following are items common to gaming and gaming related entities' financial statements that may need to be considered when designing audit procedures:

- 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

13.51 Paragraph .05 of AU-C section 330 states that the 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, assigning more experienced staff or those with specialized skills or using specialists, providing more supervision, incorporating additional elements of unpredictability in the selection of further audit procedures to be performed, or making general changes to the nature, timing, or extent of further audit procedures (for example, performing substantive procedures at period end instead of at an interim date or modifying the nature of audit procedures to obtain more persuasive audit evidence). Paragraph .A108 of AU-C section 315 explains that the risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level (for example, through management override of internal control). Financial statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud. For additional guidance relating to risk assessment procedures and related activities, refer to paragraphs .A1–.A3 of AU-C section 315.

Identification of Significant Risks

13.52 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*). Paragraph .30 of AU-C section 315 states that if the auditor has determined that significant risks exist, the auditor should obtain an

understanding of the entity's controls, including control activities, relevant to that risk and, based on that understanding, evaluate whether such controls have been suitably designed and implemented to mitigate such risks.

Analytical Procedures Used in Risk Assessment

13.53 AU-C section 315 addresses the use of analytical procedures as risk assessment procedures. Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and nonfinancial information. Refer to paragraphs .A7–.A9 of AU-C section 315 for additional analytical procedures guidance.

13.54 Analytical procedures may enhance the auditor's understanding of the client's business and the significant transactions and events that have occurred since the prior audit and also may help to identify the existence of unusual transactions or events and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud. However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures provide only a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures. See chapter 16, "Analytical Procedures," for a detailed discussion of analytical procedures relevant to a gaming entity.

Understanding of Internal Control

13.55 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, "Internal Control," for a detailed discussion of internal control as it relates to a gaming entity.⁸

13.56 Paragraphs .13–.14 of AU-C section 315 state that the auditor should obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control,

⁸ 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.

individually or in combination with others, is relevant to the audit. When obtaining an understanding of controls that are relevant to the audit. The auditor should

- a. evaluate the design of those controls relevant to an audit of financial statements, and
- b. determine whether they have been implemented by performing procedures in addition to inquiry of the entity's personnel.

13.57 Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements. Implementation of a control means that the control exists and that the entity is using it. Assessing the implementation of a control that is not effectively designed is of little use, and so the design of a control is considered first. An improperly designed control may represent a significant deficiency or material weakness in the entity's internal control.

13.58 Paragraph .A44 of AU-C section 315 explains that internal control is designed, implemented, and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern (a) the reliability of the entity's financial reporting, (b) the effectiveness and efficiency of its operations, and (c) its compliance with applicable laws and regulations.

13.59 Paragraph .A50 of AU-C section 315 states that the division of internal control into the following five components, for purposes of GAAS, provides a useful framework for auditors when considering how different aspects of an entity's internal control may affect the audit:

- a. Control environment
- b. The entity's risk assessment process
- c. The information system, including the related business processes relevant to financial reporting and communication
- d. Control activities
- e. Monitoring of controls

13.60 Paragraphs .A61–.A62 of AU-C section 315 state that a direct relationship exists between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement. The entity's objectives and, therefore, controls relate to financial reporting, operations, and compliance; however, not all of these objectives and controls are relevant to the auditor's risk assessment. Although internal control applies to the entire entity or any of its operating units or business functions, an understanding of internal control relating to each of the entity's operating units and business functions may not be necessary to the performance of the audit. Factors relevant to the auditor's professional judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

- a. Materiality
- b. The significance of the related risk
- c. The size of the entity
- d. The nature of the entity's business, including its organization and ownership characteristics

- e.* The diversity and complexity of the entity's operations
- f.* Applicable legal and regulatory requirements
- g.* The circumstances and the applicable component of internal control
- h.* The nature and complexity of the systems that are part of the entity's internal control, including the use of service organizations
- i.* Whether and how a specific control, individually or in combination with other controls, prevents, or detects and corrects, material misstatements

13.61 Paragraph .A63 of AU-C section 315 states that controls over the completeness and accuracy of information produced by the entity may be relevant to the audit if the auditor intends to make use of the information in designing and performing further audit procedures.

13.62 Paragraph .A64 of AU-C section 315 states that the controls relating to operations and compliance objectives may also be relevant to an audit if they relate to data the auditor may evaluate or use in applying audit procedures. For example, controls pertaining to nonfinancial data that the auditor may use in analytical procedures or controls pertaining to detecting noncompliance with laws and regulations that may have a direct effect on the determination of material amounts in the financial statements, such as controls over compliance with income tax laws and regulations used to determine the income tax provision, may be relevant to an audit.

13.63 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 because these procedures often do not provide sufficient audit evidence in the absence of effective controls over gaming revenues.

13.64 The auditor designs and performs tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls if the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively. In designing and performing tests of controls, the auditor obtains more persuasive audit evidence with the greater the reliance the auditor places on the effectiveness of a control.

IT Considerations

13.65 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.

13.66 A gaming entity's operations are characterized by large volumes of transactions and, therefore, generally rely heavily on computers. AU-C section 315 establishes standards and provides guidance for auditors who have been

engaged to audit an entity's financial statements when significant information is transmitted, processed, maintained, or accessed electronically.

13.67 Paragraph .A54 of AU-C section 315 states that 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 audit 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.)

13.68 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.

13.69 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-C section 402, *Audit Considerations Relating to an Entity Using a Service Organization* (AICPA, *Professional Standards*), establishes standards and provides guidance for auditors when auditing the financial statements of entities that obtain services that are part of its information system from another organization.

13.70 Specialized skills may be 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 may find it necessary to 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 may find it necessary to possess 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.

13.71 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.

13.72 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 of this guide.

Consideration of Fraud in a Financial Statement Audit

Introduction

13.73 AU-C section 240 addresses the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how AU-C sections 315 and 330 are to be applied regarding risks of material misstatement due to fraud.

13.74 Although fraud is a broad legal concept, for the purposes of GAAS, the auditor is primarily concerned with fraud that causes a material misstatement in the financial statements. In accordance with paragraph .03 of AU-C section 240, two types of intentional misstatements are relevant to the auditor:

- Misstatements resulting from fraudulent financial reporting
- Misstatements resulting from misappropriation of assets

Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.

13.75 Paragraph .A1 of AU-C section 240 states that fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so, and some rationalization of the act.

Professional Skepticism

13.76 In accordance with paragraph .12 of AU-C section 240, the auditor should maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.

13.77 Paragraphs .A9–.A10 of AU-C section 240 state that maintaining professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance when relevant. Although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance, the auditor's professional skepticism is particularly important in considering the risk of material misstatement due to fraud because there may have been changes in circumstances.

Discussion Among the Engagement Team

13.78 AU-C section 315 requires a discussion among the key engagement team members and paragraph .15 of AU-C section 240 states this discussion should include an exchange of ideas or brainstorming among the engagement team members about how and where the entity's financial statements might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated. The discussion should occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity, and should, in particular, also address

- a. known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud;
- b. the risk of management override of controls;
- c. consideration of circumstances that might be indicative of earnings management or manipulation of other financial measures and the practices that might be followed by management to manage earnings or other financial measures that could lead to fraudulent financial reporting;
- d. the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement due to fraud; and
- e. how the auditor might respond to the susceptibility of the entity's financial statements to material misstatement due to fraud.

Communication among the engagement team members about the risks of material misstatement due to fraud should continue throughout the audit, particularly upon discovery of new facts during the audit.

13.79 Paragraph .A12 of AU-C section 240 states that discussing the susceptibility of the entity's financial statements to material misstatement due to fraud with the engagement team

- provides an opportunity for more experienced engagement team members to share their insights about how and where the financial statements may be susceptible to material misstatement due to fraud.
- enables the auditor to consider an appropriate response to such susceptibility and to determine which members of the engagement team will conduct certain audit procedures.
- permits the auditor to determine how the results of audit procedures will be shared among the engagement team and how to deal with any allegations of fraud that may come to the auditor's attention during the audit.

13.80 In addition, paragraph .A13 of AU-C section 240 states the discussion may include the following matters:

- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation
- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees that have come to the attention of the engagement team
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud
- A consideration of how an element of unpredictability will be incorporated into the nature, timing, and extent of the audit procedures to be performed
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statements to material misstatement due to fraud and whether certain types of audit procedures are more effective than others
- A consideration of any allegations of fraud that have come to the auditor's attention

A number of factors may influence the extent of the discussion and how it may occur. For example, if the audit involves more than one location, there could be multiple discussions with team members in differing locations. Another factor in planning the discussions is whether to include specialists assigned to the audit team.

13.81 The following are examples of fraud risk factors that auditors may consider as part of their planning and when performing audit procedures based upon appendix A, "Examples of Fraud Risk Factors," in AU-C section 240. 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.

Incentives or Pressures

13.82 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 and foreign exchange rates)
- c. Significant declines in customer demand and increasing business failures in either the industry or overall economy, such as deteriorating economic conditions within industries or geographic regions (for example, market competition due to a neighboring jurisdiction legalizing gaming)
- 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, layoffs, and industry factors, or not reinvesting money into the gaming property

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

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

Opportunities

13.85 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 versus 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.

13.86 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

13.87 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 may 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, gaming laws and regulations, 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 the internal audit function
- 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

13.88 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.

13.89 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.

13.90 *Incentives and Pressures*

- 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.

13.91 *Opportunities*

1. 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.
2. 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,

Attitudes and Rationalization

1. Disregard for the need for monitoring or reducing risks related to misappropriations of assets
2. Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control
3. Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee
4. Changes in behavior or lifestyle that may indicate assets have been misappropriated
5. The belief by some government or other officials that their level of authority justifies a certain level of compensation and personal privileges
6. Tolerance of petty theft

Risk Assessment Procedures and Related Activities

13.92 When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by AU-C section 315, paragraph .16 of AU-C section 240 states that the auditor should perform the procedures in paragraphs .17–.24 of AU-C section 240 to obtain information for use in identifying the risk of material misstatement due to fraud. As part of this work, the auditor should perform the following:

- a. Make inquiries about fraud with management, others within the entity, and those charged with governance (unless all those charged with governance are involved in managing the entity). See specific inquiries the auditor should make in paragraphs .17–.19 and .21 of AU-C section 240.
- b. Obtain an understanding of how those charged with governance exercise oversight of management's process for identifying and responding to the risks of fraud in the entity and the internal control

that management has established to mitigate these risks, unless all those charged with governance are involved in managing the entity. (See paragraphs .20 and .A21–.A23 of AU-C section 240.)

- c. Evaluate whether any unusual or unexpected relationships that have been identified (based on analytical procedures performed as part of risk assessment procedures) indicate risks of material misstatement due to fraud. (See paragraphs .22, .A24–.A26, and .A46 of AU-C section 240.)
- d. Consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud. (See further application guidance in paragraph .A27 of AU-C section 240.)
- e. Evaluate whether the information obtained from the risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. (See paragraphs .24 and .A28–.A32 of AU-C section 240.)

13.93 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

Evaluation of Fraud Risk Factors

13.94 As indicated in paragraphs 13.78–.84 in this chapter, 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. Although fraud risk factors may not necessarily indicate the existence of fraud, paragraph .24 of AU-C section 240 states that they have often been present in circumstances in which frauds have occurred and, therefore may indicate risks of material misstatement due to fraud.

13.95 Paragraph .A31 of AU-C section 240 states that the size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. Additional fraud risk factor considerations for both large and smaller, less complex entities can be found in paragraphs .A31–.A32 of AU-C section 240. Furthermore, appendix A of AU-C section 240 identifies examples of fraud risk factors that may be faced by auditors in a broad range of situations.

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

13.96 Paragraph .25 of AU-C section 240 states that the auditor should identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances, and disclosures. The auditor's risk assessment should be ongoing throughout the audit, following the initial assessment.

13.97 Some examples of risks that may be identified and that may result in a material misstatement due to fraud for gaming entities include the following:

- a. *Property and equipment accounting.* Fixed assets tend to be the largest asset for a gaming entity, and although the primary gaming entity's 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, and a determination may be needed regarding whether expenditures are capital in nature or repairs and maintenance. A small change in estimated useful lives may cause significant changes in reported income. In many cases, it can be difficult to maintain detailed fixed asset records, thereby increasing the potential for fraud related to the 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.

13.98 Paragraph .26 of AU-C section 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor should, based on a presumption that risks of fraud exist in revenue recognition, evaluate which types of revenue, revenue transactions, or assertions give rise to such risks. Paragraph .46 of AU-C section 240 specifies the documentation required when the auditor concludes that the presumption is not applicable in the

circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (See paragraphs .A33–.A35 of AU-C section 240 for application guidance of fraud risks in revenue recognition).⁹ However, factors which may mitigate 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 consists of large numbers of individually small transactions.
- b. There are 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.

13.99 Paragraph .27 of AU-C section 240 states that the auditor should treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor should obtain an understanding of the entity's related controls, including control activities, relevant to such risks, including the evaluation of whether such controls have been suitably designed and implemented to mitigate such fraud risks. (See paragraphs .A36–.A37 of AU-C section 240 for application guidance on identifying and assessing the risks of material misstatement due to fraud and understanding the entity's related controls.) Some examples of programs and controls in the gaming industry are described in chapter 15 of this guide.

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses

13.100 Paragraphs .28–.29 of AU-C section 240 state that the auditor should determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. Accordingly, the auditor should

- a. assign and supervise personnel, taking into account the knowledge, skill, and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement;
- b. evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings, or a bias that may create a material misstatement; and
- c. incorporate an element of unpredictability in the selection of the nature, timing, and extent of audit procedures.

See paragraphs .A38–.A42 of AU-C section 240 for additional application guidance on overall responses to the assessed risks of material misstatement due to fraud.

⁹ For information regarding identifying significant auditing considerations relevant to auditing revenue under FASB *Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers*, for nongovernmental entities, see the AICPA Audit and Accounting Guide, *Revenue Recognition*.

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level

13.101 Paragraph .30 of AU-C section 240 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 due to fraud at the assertion level. (See paragraphs .A43–.A46 of AU-C section 240 for further application guidance.)

Audit Procedures Responsive to Risks Related to Management Override of Controls

13.102 Even if specific risks of material misstatement due to fraud are not identified by the auditor, paragraph .32 of AU-C section 240 states that a possibility exists that management override of controls could occur. Accordingly, the auditor should address that risk of management override of controls apart from any conclusions regarding the existence of more specifically identifiable risks by designing and performing audit procedures to

- a. test the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparation of the financial statements, including entries posted directly to financial statement drafts,
- b. review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud, and
- c. evaluate, for significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, whether the business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

Evaluation of Audit Evidence

13.103 AU-C section 500, *Audit Evidence* (AICPA, *Professional Standards*), provides requirements and application guidance for evaluating audit evidence. As stated in paragraph .34 of AU-C section 240, the auditor should evaluate, at or near the end of the audit, whether the accumulated results of auditing procedures, including analytical procedures that were performed as substantive tests or when forming an overall conclusion, affect the assessment of the risks of material misstatement due to fraud made earlier in the audit or indicate a previously unrecognized risk of material misstatement due to fraud.

13.104 Paragraph .28 of AU-C section 330 states the auditor should conclude whether sufficient appropriate audit evidence has been obtained. In forming conclusion, 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.

13.105 Paragraph .35 of AU-C section 240 states that if the auditor identifies a misstatement, the auditor should evaluate whether such misstatement is indicative of fraud. If such an indication exists, the auditor should evaluate the implications of the misstatement with regard to other aspects of the audit, particularly the auditor's evaluation of materiality, management and employee

integrity, and the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. Furthermore, paragraph .36 of AU-C section 240 states if the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is, or may be, the result of fraud and that management (in particular, senior management) is involved, the auditor should reevaluate the assessment of the risks of material misstatement due to fraud and its resulting effect on the nature, timing, and extent of audit procedures to respond to the assessed risks. The auditor should also consider whether circumstances or conditions indicate possible collusion involving employees, management, or third parties when reconsidering the reliability of evidence previously obtained.

13.106 Paragraph .A60 of AU-C section 240 states that the implications of identified fraud depend on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of evidence previously obtained may be called into question because there may be doubts about the completeness and truthfulness of representations made and genuineness of accounting records and documentation. There may also be a possibility of collusion involving employees, management, or third parties.

13.107 Paragraph .37 of AU-C section 240 states that if the auditor concludes that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor should evaluate the implications for the audit. AU-C sections 450 and 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*), address the evaluation and disposition of misstatements and the effect on the auditor's opinion in the auditor's report.

Auditor Unable to Continue the Engagement

13.108 Paragraph .38 of AU-C section 240 states that if, as a result of identified fraud or suspected fraud, the auditor encounters circumstances that bring into question the auditor's ability to continue performing the audit, the auditor should

- a. determine the professional and legal responsibilities applicable in the circumstances, including whether a requirement exists for the auditor to report to the person or persons who engaged the auditor or, in some cases, to regulatory authorities;
- b. consider whether it is appropriate to withdraw from the engagement, when withdrawal is possible under applicable law or regulation; and
- c. if the auditor withdraws
 - i. discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal, and
 - ii. determine whether a professional or legal requirement exists to report to the person or persons who engaged the auditor or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Given the nature of the circumstances and the need to consider the legal requirements, paragraph .A65 of AU-C section 240, states that the auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to regulators or others. For additional application guidance, including examples of circumstances that may arise and bring into question the auditor's ability to continue performing the audit, see paragraphs .A63–.A65 of AU-C section 240.

Communications to Management and With Those Charged With Governance

13.109 Paragraph .39 of AU-C section 240 states if the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor should communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. As stated in paragraph .A67 of AU-C section 240, when the auditor has obtained evidence that fraud exists or may exist, it is important that the matter be brought to the attention of the appropriate level of management as soon as practicable. This is true even if the matter might be considered inconsequential (for example, a minor defalcation by an employee at a low level in the entity's organization).

13.110 Unless all of those charged with governance are involved in managing the entity, paragraphs .40–.41 of AU-C section 240 state that, if the auditor has identified or suspects fraud involving (a) management, (b) employees who have significant roles in internal control, or (c) others, when the fraud results in a material misstatement in the financial statements, the auditor should communicate these matters to those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor should communicate these suspicions to those charged with governance and discuss with them the nature, timing, and extent of audit procedures necessary to complete the audit. In addition, the auditor should communicate with those charged with governance any other matters related to fraud that are, in the auditor's professional judgment, relevant to their responsibilities. See paragraphs .A68–.A71 of AU-C section 240 for further application guidance concerning communications with those charged with governance.

Documentation

13.111 Paragraphs .43–.46 of AU-C section 240 address requirements for certain items and events to be documented by the auditor in relation to assessed risks of material misstatement due to fraud.

Consideration of Laws and Regulations

13.112 AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* (AICPA, *Professional Standards*), addresses the auditor's responsibility to consider laws and regulations in an audit of financial statements. However, it does not apply to other assurance engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws and regulations.

Responsibility for Compliance With Laws and Regulations

Responsibility of Management

13.113 In accordance with paragraph .03 of AU-C section 250, it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

Responsibility of the Auditor

13.114 The requirements in AU-C section 250 are designed to assist the auditor in identifying material misstatement of the financial statements due to noncompliance with laws and regulations. However, paragraph .04 of AU-C section 250 recognizes that the auditor is not responsible for preventing noncompliance and cannot be expected to detect noncompliance with all laws and regulations. Additionally, paragraphs .21–.27 of AU-C section 250 describe the auditor's responsibility to report noncompliance to those charged with governance. For purposes of discussion in AU-C section 250, the term *noncompliance* is defined as acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations.

13.115 Some laws and regulations have a direct and possibly material effect on the determination of financial statement amounts. 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

13.116 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 F of this guide.

13.117 Refer to paragraphs .17–.20 and .A19–.A25 of AU-C section 250 for a list of procedures for the auditor to perform when noncompliance is found or suspected.

Audit Performance and Execution

Designing and Performing Further Audit Procedures

13.118 AU-C section 330 addresses the auditor's responsibility to design and implement responses to the risks of material misstatement identified and

assessed by the auditor in accordance with AU-C section 315, and to evaluate the audit evidence obtained in an audit of financial statements.

13.119 Paragraph .05 of AU-C section 330 states that the auditor should design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. Paragraph .A1 of AU-C section 330 states that 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, assigning more experienced staff or those with specialized skills or using specialists, providing more supervision, incorporating additional elements of unpredictability in the selection of further audit procedures to be performed, or making general changes to the nature, timing, or extent of further audit procedures (for example, performing substantive procedures at period end instead of at an interim date or modifying the nature of audit procedures to obtain more persuasive audit evidence).

Overall Responses

13.120 Further audit procedures provide important audit evidence to support an audit opinion. These procedures may consist of tests of controls and substantive tests. Paragraph .06 of AU-C section 330 states that the auditor should design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level.

13.121 In designing the further audit procedures to be performed, paragraph .07 of AU-C section 330 states that the auditor should

- a. consider the reasons for the assessed risk of material misstatement at the relevant assertion level for each class of transactions, account balance, and disclosure, including
 - i. the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (the inherent risk) and
 - ii. whether the risk assessment takes account of relevant controls (the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures), and
- b. obtain more persuasive audit evidence the higher the auditor's assessment of risk

13.122 *Tests of controls.* In accordance with paragraph .08 of AU-C section 330, the auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls if (a) the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive

procedures)¹⁰ or (b) when substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level. In accordance with paragraph .A21 of AU-C section 330, tests of controls are performed only on those controls that the auditor has determined are suitably designed to prevent, or detect and correct, a material misstatement in a relevant assertion. If substantially different controls were used at different times during the period under audit, each is considered separately.

13.123 Paragraph .A22 of AU-C section 330 states that the testing the operating effectiveness of controls is different from obtaining an understanding and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The auditor may determine it is efficient to test the operating effectiveness of controls at the same time the auditor is evaluating their design and determining that they have been implemented.

13.124 Paragraph .A23 of AU-C section 330 states that although some risk assessment procedures may not have been specifically designed as tests of controls, they may, nevertheless, provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls.

13.125 Irrespective 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, in accordance with paragraph .18 of AU-C section 330.

13.126 Paragraph .21 of AU-C section 330 states that the auditor's substantive procedures should include audit procedures related to the financial statement closing process, such as

- agreeing or reconciling the financial statements, with the underlying accounting records, and
- examining material journal entries and other adjustments made during the course of preparing the financial statements.

Paragraph .A57 of AU-C section 330 states that 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 process and the associated risks of material misstatement.

Timing of Audit Procedures

13.127 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.

13.128 Tests of controls over accountability and gaming revenue are generally performed periodically during the year. These audit procedures include observations of compliance with controls, such as those relating to the cage,

¹⁰ Q&A section 8200.06, "The Meaning of Expectation of the Operating Effectiveness of Controls" (AICPA *Technical Questions and Answers*), states that the phrase *expectation of the operating effectiveness of controls* means that the auditor's understanding of the five components of internal control has enabled the auditor 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 Q&A section 8200.06.

count rooms, *pit*, and other gaming operating procedures. Specifically, these audit procedures may 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.

13.129 The observation of the cash count, the principal substantive test regarding existence of cash for a gaming entity, generally may be done as of the balance sheet date, but may be performed at an earlier or later time. Paragraph .A60 of AU-C section 330 states that in some circumstances, the auditor may determine that it is effective to perform substantive procedures at an interim date and compare and reconcile information concerning the balance at the period-end with the comparable information at the interim date to identify amounts that appear unusual, investigate any such amounts, and perform substantive analytical procedures or tests of details to test the intervening period. Additionally, paragraph .A61 of AU-C section 330 notes that performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that the auditor will not detect misstatements that may exist at the period-end. This risk increases as the remaining period is lengthened. Factors such as the following may influence whether to perform substantive procedures at an interim date:

- The effectiveness of the control environment and other relevant controls
- The availability at a later date of information necessary for the auditor's procedures
- The purpose of the substantive procedure
- The assessed risk of material misstatement
- The nature of the class of transactions or account balance and relevant assertions
- The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that may exist at the period-end will not be detected

13.130 In normal circumstances, when an auditor is appointed to perform an audit that is close to an entity's year end the timing of the observation of inventory is critical, and the 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 the audit, the scope of the audit may be limited, and the opinion may be appropriately qualified or disclaimed. Refer to chapter 14, "Special Auditing Considerations," for additional special auditing considerations.

Analytical Procedures Used in Audit Performance

13.131 AU-C section 520, *Analytical Procedures* (AICPA, *Professional Standards*), establishes standards and provides guidance on the use of analytical procedures as substantive procedures. AU-C section 520 also addresses the auditor's responsibility to perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements. Analytical procedures are defined in paragraph .04 of AU-C section 520 as evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

13.132 The objectives of the auditor when performing analytical procedures is to obtain relevant and reliable audit evidence when using substantive analytical procedures and design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion about whether the financial statements are consistent with the auditor's understanding of the entity.

13.133 When substantive analytical procedures have been performed, paragraph .08 of AU-C section 520 states that the auditor should include in the audit documentation the following:

- a. The expectation and the factors considered in its development, when that expectation or those factors are not otherwise readily determinable from the audit documentation.
- b. Results of the comparison of the of the recorded amounts, or ratios developed from recorded or ratios developed from recorded amounts, with the expectations.
- c. Any additional auditing procedures performed relating to the investigation of fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount and the results.

13.134 Paragraphs .A13–.A14 of AU-C section 520 explain that different types of analytical procedures provide different levels of assurance. The determination of the suitability of particular substantive analytical procedures is influenced by the nature of the assertion and the auditor's assessment of the risk of material misstatement. Paragraph of .A8 of AU-C section 520 states that the effectiveness and efficiency of a substantive analytical procedure in addressing risks of material misstatement 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, paragraph .A19 of AU-C section 520 notes that the auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing the substantive analytical procedures in response to assessed risks. When such controls are effective, the auditor may have greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The operating effectiveness of controls over nonfinancial information may often be tested in conjunction with

other tests of controls or perform other procedures to support the completeness and accuracy of the underlying information.

13.135 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.

Audit Documentation

13.136 AU-C section 230, *Audit Documentation* (AICPA, *Professional Standards*), addresses the auditor's responsibility to prepare audit documentation for an audit of financial statements. The exhibit, "Audit Documentation Requirements in Other AU-C Sections," of AU-C section 230 lists other AU-C sections that contain specific documentation requirements and guidance. The specific documentation requirements of other AU-C sections do not limit the application of AU-C section 230. Laws, regulations, or other standards may establish additional documentation requirements.

13.137 Paragraph .02 of AU-C section 230 states that the audit documentation that meets the requirements of AU-C section 230 and the specific documentation requirements of other relevant AU-C sections provides

- a. evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor;¹¹ and
- b. evidence that the audit was planned and performed in accordance with GAAS and applicable legal and regulatory requirements.

13.138 For purposes of GAAS, *audit documentation*, as defined in paragraph .06 of AU-C section 230, is the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as *working papers* or *workpapers* are also sometimes used).

Timely Preparation of Audit Documentation

13.139 Paragraph .07 of AU-C section 230 states that the auditor should prepare audit documentation on a timely basis. Paragraph .A3 of AU-C section 230 further explains that preparing sufficient and appropriate audit documentation on a timely basis throughout the audit helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared at the time such work is performed or shortly thereafter is likely to be more accurate than documentation prepared at a much later time.¹²

13.140 Paragraphs .08–.12 of AU-C section 230 address the auditor's responsibilities regarding documentation of the auditor procedures performed

¹¹ Paragraph .12 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*).

¹² 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 paragraphs .17–.19 of AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*).

and audit evidence obtained including form, content, and extent of audit documentation. In accordance with paragraph .08 of AU-C section 230, the auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand

- a. the nature, timing, and extent of the audit procedures performed to comply with GAAS and applicable legal and regulatory requirements; (Readers can find additional application and explanatory material in paragraphs .A8–.A9 of AU-C section 230.)
- b. the results of the audit procedures performed, and the audit evidence obtained; and
- c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Readers can find additional application and explanatory material in paragraphs .A10–.A13 of AU-C section 230.)

As stated in paragraph .A5 of AU-C section 230, examples of audit documentation include audit plans, analyses, issues memorandums, summaries of significant findings or issues, letters of confirmation and representation, checklists, and correspondence (including e-mail) concerning significant findings or issues.

13.141 For audit procedures related to the inspection of significant contracts or agreements, paragraph .10 of AU-C section 230 states that the auditor should include abstracts or copies of those contracts or agreements in the audit documentation.

13.142 In addition to the requirements discussed previously, paragraphs .13–.14 of AU-C section 230 address further documentation requirements about departures from relevant requirements and matters arising after the date of the auditor's report.

Assembly and Retention of the Final Audit File

13.143 Paragraphs .15–.19 of AU-C section 230 address an auditor's responsibilities regarding assembly and retention of the final audit file. Paragraph .16 of AU-C section 230 states that the auditor should assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis, no later than 60 days following the report release date.

Auditor's Consideration of Using the Work of Internal Auditors

13.144 AU-C section 610, *Using the Work of Internal Auditors* (AICPA, *Professional Standards*), addresses the external auditor's responsibilities of using the work of internal auditors. Using the work of internal auditors includes (a) using the work of the internal audit function in obtaining audit evidence, and (b) using internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor. AU-C section 610 requires, among other things, as a prerequisite to being able to use the work of the internal audit function, that the external auditor evaluate the application by the internal audit function of a systematic and disciplined approach, including quality control.

Using the Work of Other Specialists

13.145 AU-C section 620, *Using the Work of an Auditor's Specialist* (AICPA, *Professional Standards*), addresses the auditor's responsibilities relating to the work of an individual or organization possessing expertise in a field other than accounting or auditing when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's specialist may be either an auditor's internal specialist (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm) or an auditor's external specialist.

13.146 AU-C section 620 does not cover the use of a specialist who has a relationship with the client, including situations where the client has the ability to directly or indirectly control or significantly influence the specialist. However, paragraph .09 of AU-C section 620 states that, in the case of an auditor's external specialist, the evaluation of objectivity should include inquiry regarding interests and relationships that may create a threat to the objectivity of the auditor's specialist. If the auditor believes that a relationship between the entity and the auditor's specialist might impair the objectivity of the auditor's specialist's, paragraph .A22 of AU-C section 620 states that the auditor may perform additional procedures with respect to some or all of the assumptions, methods, or findings of the auditor's specialist to determine that the findings are reasonable or may engage another specialist for that purpose.

13.147 AU-C section 620 does not address

- situations in which the engagement team includes a member or consults an individual or organization with expertise in a specialized area of accounting or auditing, which are addressed in AU-C sections 220 and 300^{13,14} or
- auditor's use of the work of an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (a management's specialist), which is addressed in AU-C section 500.¹⁵

13.148 Paragraph .09 of AU-C section 620 states that the auditor should evaluate whether the auditor's specialist has the necessary competence, capabilities, and objectivity for the auditor's purposes. For example, if the auditor is using an appraisal of commercial real estate values in connection with the audit of financial statements, the auditor should evaluate the appraiser's professional qualifications and their experience with commercial real estate in the gaming industry.

13.149 In a number of cases, the specialist's work may have been prepared for another purpose. In these situations, paragraph .10 of AU-C section 620 states that the auditor should obtain a sufficient understanding of the field of expertise of the auditor's specialist to enable the auditor to

- determine the nature, scope, and objectives of the work of the auditor's specialist for the auditor's purposes and
- evaluate the adequacy of that work for the auditor's purposes.

¹³ Paragraphs .A10 and .A20–.A22 of AU-C section 220.

¹⁴ Paragraph .12 of AU-C section 300, *Planning an Audit* (AICPA, *Professional Standards*).

¹⁵ Paragraphs .A35–.A49 of AU-C section 500, *Audit Evidence* (AICPA, *Professional Standards*).

Evaluation of Misstatements Identified During the Audit

13.150 Based on the results of substantive procedures, the auditor may identify misstatements in accounts or notes to the financial statements. AU-C section 450 addresses the auditor's responsibility to evaluate the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements. Paragraphs .05–.12 of AU-C section 450 address specific requirements the auditor should perform in relation to accumulation of identified misstatements, consideration of identified misstatements as the audit progresses, communication and correction of misstatements, evaluating the effect of uncorrected misstatements and documentation.

13.151 AU-C section 700 addresses the auditor's responsibility in forming an opinion on the financial statements based on the evaluation of the audit evidence obtained. The auditor's conclusion, as required by AU-C section 700, takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements. AU-C section 450 explains how materiality is applied in evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements.

Written Representations

13.152 AU-C section 580 addresses the auditor's responsibility to obtain written representations from management, and when appropriate, those charged with governance, in an audit of financial statements. AU-C section 580 also provides exhibit C, "List of AU-C Sections Containing Requirements for Written Representations," that lists other AU-C sections containing subject matter-specific requirements for written representations.

Written Representations as Audit Evidence

13.153 According to paragraphs .03–.04 of AU-C section 580, written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Although written representations provide necessary audit evidence, they complement other auditing procedures and do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, obtaining reliable written representations does not affect the nature or extent of other audit procedures that the auditor applies to obtain audit evidence about the fulfillment of management's responsibilities or about specific assertions.

Management From Whom Written Representations Are Requested

13.154 As explained in paragraph .A2 of AU-C section 580, written representations are requested from those with overall responsibility for financial and operating matters whom the auditor believes are responsible for, and knowledgeable about, directly or through others in the organization, the matters covered by the representations, including the preparation and fair presentation of the financial statements. As such, in accordance with paragraph .09 of AU-C section 580, the auditor should request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.

13.155 Paragraph .A2 of AU-C section 580 further states that those individuals with overall responsibility may vary depending on the governance structure of the entity; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer or other equivalent persons in entities that do not use such titles. In some circumstances, other parties, such as those charged with governance, are responsible for the preparation and fair presentation of the financial statements, and would be considered the responsible party for this purpose.

Written Representations About Management's Responsibilities and Other Written Representations

13.156 Paragraphs .10–.18 of AU-C section 580 discuss matters the auditor should request management to provide written representation about such as preparation and fair presentation of the financial statements, information provided and completeness of transactions, fraud, laws and regulations, uncorrected misstatements, litigation and claims, estimates, related party transactions, and subsequent events. If, in addition to such required representations and those addressed in other AU-C sections,¹⁶ the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, paragraphs .19 of AU-C section 580 states that the auditor should request such other written representations. Management's written representations specific to gaming may include the following:

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

13.157 Paragraph .A22 of AU-C section 580 states that 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. Materiality may be different for different representations. A discussion of materiality may be included explicitly in the representation letter in either qualitative or quantitative terms. Materiality considerations do not apply to those representations that are not directly related to amounts included in the financial statements (for example, management's representations about the premise underlying the audit). In addition, because of the possible effects of fraud on other aspects of the audit, materiality would not apply to management's acknowledgment regarding its responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

Date of, and Period(s) Covered by, Written Representations

13.158 Paragraph .20 of AU-C section 580 states that the date of the written representations should be as of the date of the auditor's report on the financial statements. The written representations should be for all financial statements and period(s) referred to in the auditor's report.

¹⁶ As stated in paragraph .02 of AU-C section 580, *Written Representations* (AICPA, *Professional Standards*), exhibit C, "List of AU-C Sections Containing Requirements for Written Representations," lists other AU-C sections containing subject matter-specific requirements for written representations. The specific requirements for written representations of other AU-C sections do not limit the application of this section.

Form of Written Representations

13.159 In accordance with paragraph .21 of AU-C section 580, the written representations should be in the form of a representation letter addressed to the auditor.

Doubt About the Reliability of Written Representations and Requested Written Representations Not Provided

13.160 Paragraph .25 of AU-C section 580 states that the auditor should disclaim an opinion on the financial statements in accordance with AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*), or withdraw from the engagement if

- a. the auditor concludes that sufficient doubt exists about the integrity of management such that the written representations required by paragraphs .10–.11 of AU-C section 580 are not reliable or
- b. management does not provide the written representations required by paragraphs .10–.11 of AU-C section 580.

Communication With Those Charged With Governance

13.161 AU-C section 260, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*), addresses the auditor's responsibility to communicate with those charged with governance in relation to an audit of financial statements. Although AU-C section 260 applies regardless of an entity's governance structure or size, particular considerations apply where 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.

13.162 AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*), addresses the auditor's responsibility to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. In particular, AU-C section 265

- 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.

13.163 Paragraphs .11–.13 and .14b of AU-C section 265 describe that the auditor should communicate in writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, and an explanation of their potential effects, including those that were remediated during the audit. The auditor also should communicate to management at an appropriate level of responsibility, on a timely basis

- a. in writing, significant deficiencies and material weaknesses that the auditor has communicated or intends to communicate to those

charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances.

- b. in writing or orally, other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. If other deficiencies in internal control are communicated orally, the auditor should document the communication.

The communication referred to should be made no later than 60 days following the report release date. However, paragraph .A15 of AU-C section 265 further explains the communication is best made by the report release date because receipt of such communication may be an important factor in enabling those charged with governance to discharge their oversight responsibilities.

13.164 In accordance with paragraph .03 of AU-C section 265, nothing in AU-C section 265 precludes the auditor from communicating to those charged with governance or management other internal control matters that auditor has identified during the audit.

13.165 The appendix, "Examples of Circumstances That May Be Deficiencies, Significant Deficiencies, or Material Weaknesses," of AU-C section 265 includes examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses.

13.166 AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (AICPA, *Professional Standards*) is applicable if the auditor is engaged to report on the effectiveness of an entity's internal control over financial reporting.

Auditor's Consideration of Going Concern¹⁷

13.167 AU-C section 570A, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*), addresses the auditor's responsibilities in an audit of financial statements with respect to evaluating whether there is a substantial doubt about the entity's ability to continue as a going concern. According to paragraph .02 of AU-C section 570A, continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Ordinarily, information that significantly contradicts the going concern assumption relates to the entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions. The auditor's responsibility, in accordance with paragraph .03 of AU-C section 570A, is to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. A reasonable period of time, as defined in paragraph .07 of AU-C section 570A, is a period of time not to exceed one year beyond the date of the financial

¹⁷ FASB ASC 205-40, *Presentation of Financial Statements—Going Concern*, provides guidance regarding management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern. Similarly, GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, provides requirements for financial statement preparers as it relates to a governmental entity's ability to continue as a going concern. Refer to those standards for additional information regarding management's responsibility.

statements being audited. The auditor's evaluation is based on the auditor's knowledge of relevant conditions or events that exist at, or have occurred prior to, the date of the auditor's report. Information about such conditions or events is obtained from the application of audit procedures planned and performed to achieve audit objectives that are related to management's assertions embodied in the financial statements being audited, as described in AU-C section 315.

13.168 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 .06 of AU-C section 570A, the objectives of the auditor are to

- a. evaluate and conclude, based on the audit evidence obtained, whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time;
- b. assess the possible financial statement effects, including the adequacy of disclosure regarding uncertainties about the entity's ability to continue as a going concern for a reasonable period of time; and
- c. determine the implications for the auditor's report.

Audit Procedures

13.169 The auditor should evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time based on the results of the audit procedures performed pursuant to paragraphs .09–.11 and .14 of AU-C section 570A, as follows:

- The auditor should consider whether the results of the procedures performed during the course of the audit identify conditions or 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. The auditor should consider the need to obtain additional information about such conditions or events, as well as the appropriate audit evidence to support information that mitigates the auditor's doubt.
- If, after considering the identified conditions or events in the aggregate, the auditor believes there is substantial doubt 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 that are intended to mitigate the adverse effects of such conditions or events. The auditor should
 - assess whether it is likely that the adverse effects would be mitigated by management's plans for a reasonable period of time;
 - identify those elements of management's plans that are particularly significant to overcoming the adverse effects of the conditions or events and plan and perform procedures to obtain audit evidence about them, including, when applicable, considering the adequacy of support regarding the ability to obtain additional financing or the planned disposal of assets; and
 - assess whether it is likely that such plans can be effectively implemented.

- When prospective financial information is particularly significant to management's plans, the auditor should request management to provide that information and should consider the adequacy of support for significant assumptions underlying that information. The auditor should give particular attention to assumptions that are material to the prospective financial information, especially sensitive or susceptible to change, or inconsistent with historical trends. The auditor's consideration should be based on knowledge of the entity, its business, and its management and should include (a) reading the prospective financial information and the underlying assumptions and (b) comparing prospective financial information from prior periods with actual results and comparing prospective information for the current period with results achieved to date. If the auditor becomes aware of factors, the effects of which are not reflected in such prospective financial information, the auditor should discuss those factors with management and, if necessary, request revision of the prospective financial information.
- If the auditor believes, before consideration of management's plans pursuant to paragraph .10 of AU-C section 570A, there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should obtain written representations from management
 - regarding its plans that are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and the likelihood that those plans can be effectively implemented, and
 - that the financial statements disclose all the matters of which management is aware that are relevant to the entity's ability to continue as a going concern, including principal conditions or events and management's plans.

13.170 Paragraph .A1 of AU-C section 570A 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 entity's ability to continue as a going concern for a reasonable period of time. The results of audit procedures designed and performed to identify and assess risk in accordance with AU-C section 315, gather audit evidence in response to assessed risks in accordance with AU-C section 330, and complete the audit are expected to be sufficient for that purpose. The following are examples of procedures 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 stockholders, 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 reports of significant examinations and related communications between regulators and the gaming entity
- h. Review of compliance with regulatory requirements

Consideration of Conditions and Events

13.171 In performing such audit procedures noted previously, paragraph .A2 of AU-C section 570A states that the auditor may identify information about certain conditions or 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. The significance of such conditions and events will depend on the circumstances, and some conditions or events 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:

- *Negative trends*—for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, adverse key financial ratios.
- *Other indications of possible financial difficulties*—for example, default on loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring of debt, noncompliance with statutory capital requirements, need to seek new sources or methods of financing or to dispose of substantial assets.
- *Internal matters*—for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, need to significantly revise operations.
- *External matters*—for example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; uninsured or underinsured catastrophe such as a drought, earthquake, or flood; concerns expressed or actions taken by regulatory authorities regarding alleged unsafe or unsound practices; indications of strained relationships between management and regulatory authorities.

Consideration of Financial Statement Effects

13.172 Paragraphs .12–.13 of AU-C section 570A state that when, after considering management's plans, the auditor concludes there is substantial doubt about the 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 disclosure. When the auditor concludes, primarily because of the auditor's consideration of management's plans, that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated, the auditor should consider the need for, and evaluate the adequacy of, disclosure of the principal conditions or events that initially caused the auditor to believe there was substantial doubt. The auditor's consideration of disclosure should include the possible effects of such conditions or events, and any mitigating factors, including management's plans. In consideration of the adequacy of disclosure, paragraph

.A4 of AU-C section 570A states that some of the information that might be disclosed includes the following:

- a. Principal conditions or events giving rise to the assessment of substantial doubt about the entity'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 discontinuance of operations
- e. Management's plans (including relevant prospective financial information)
- f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

Consideration of the Effects on the Auditor's Report

13.173 Paragraph .15 of AU-C section 570A states that if, after considering identified conditions or 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 auditor should include an emphasis-of-matter paragraph to reflect that conclusion. See AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*) for additional information. For additional guidance regarding the effect on the auditor's report refer to paragraphs .16–.18 and .A6–.A8 of AU-C section 570A.

Communicate With Those Charged With Governance

13.174 If, after the auditor considers the identified conditions or events in the aggregate along with considering 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, paragraph .19 of AU-C section 570A states that the auditor should communicate the following to those charged with governance:

- The nature of the conditions or events identified
- The possible effect on the financial statements and the adequacy of related disclosures in the financial statements
- The effects on the auditor's report

AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*), addresses the auditor's responsibilities in an audit of financial statements with respect to evaluating whether there is a substantial doubt about the entity's ability to continue as a going concern.¹⁸ Paragraph .02 of AU-C section 570 states that under the going concern basis of accounting, the financial statements are

¹⁸ Statement on Auditing Standards (SAS) No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, AU-C sec. 570), was issued in February 2017. This SAS is effective for audits of financial statements for periods ending on or after December 15, 2017.

prepared on the assumption that the entity is a going concern and will continue its operations for a reasonable period of time. A complete set of general purpose financial statements is prepared using the going concern basis of accounting, unless the liquidation basis of accounting is appropriate.

If required under the applicable financial reporting framework, one of management's responsibilities is to evaluate the entity's ability to continue as a going concern for a reasonable period of time and provide disclosures related to the entity's ability to continue as a going concern. Management's evaluation of the entity's ability to continue as a going concern for a reasonable period of time involves making a judgement, at a particular point in time, about inherently uncertain future outcomes of conditions or events. Paragraph .A7 of AU-C section 570 includes examples of adverse conditions and events that may raise substantial doubt about the entity's ability to continue as a going concern.

Gaming entities operate in a highly regulated environment. As a result, laws and regulations can have a significant effect on their operations and may impact the auditor's consideration of an entity's ability to continue as a going concern. The auditor's objectives in the audit of financial statements relating to the entity's ability to continue as a going concern are set forth in paragraph .10 of AU-C section 570. The objectives are to

- obtain sufficient appropriate audit evidence regarding, and to conclude on, the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements,
- conclude, based on the audit evidence obtained, whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exists,
- evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time, and
- report in accordance with AU-C section 570.

Paragraph .11 of AU-C section 570 defines a reasonable period of time as the period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). FASB and GASB specify such period of time as follows:

- FASB. Within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). FASB ASC 205-40-50-1.
- GASB. 12 months beyond the date of the financial statements. GASB further requires that, if a governmental entity currently knows information that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered). Paragraph 16 of GASB Statement No. 56.

Risk Assessment Procedures and Related Activities

Paragraph .12 of AU-C section 570 states that when performing risk assessment procedures as required by AU-C section 315, the auditor should consider whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. In doing so, the auditor should determine whether management has performed a preliminary evaluation of whether such conditions or events exist:

- If such an evaluation has been performed, the auditor should discuss the evaluation with management and determine whether management has identified conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time and, if so, understand management's plans to address them.
- If such an evaluation has not yet been performed, the auditor should discuss with management the basis for the intended use of the going concern basis of accounting and inquire of management whether conditions or events exist that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

The auditor should remain alert throughout the audit for audit evidence of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. Furthermore, the auditor should inquire of management regarding its knowledge of conditions or events beyond the period of management's evaluation that may have an effect on the entity's ability to continue as a going concern.

Additional Audit Procedures

As part of obtaining sufficient appropriate audit evidence to determine whether conditions and events identified, considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should perform additional audit procedures, including consideration of mitigating factors, as set forth in paragraph .16 of AU-C section 570. These procedures include the following:

- Requesting management to make an evaluation when management has not yet performed an evaluation
- Evaluating management's plans in relation to its going concern evaluation, with regard to whether it is probable that
 - management's plans can be effectively implemented and
 - the plans would mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- When the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in evaluating management's plans,
 - evaluating the reliability of the underlying data generated to prepare the forecast and

- determining whether there is adequate support for the assumptions underlying the forecast, which includes considering contradictory audit evidence
- Considering whether any additional facts or information have become available since the date on which management made its evaluation

When management's plans include financial support by third parties or the entity's owner-manager (supporting parties), and such support is necessary in supporting management's assertions about the entity's ability to continue as a going concern for a reasonable period of time, the auditor has additional responsibilities as found in paragraph .17 of AU-C section 570. Sufficient appropriate audit evidence is required regarding the intent of the supporting parties to provide the necessary financial support, including written evidence of such intent. In addition, the auditor should obtain audit evidence that the supporting third parties are able to provide the necessary financial support. Failure to obtain written evidence of the intent of the supporting parties to provide the necessary financial support constitutes a lack of sufficient appropriate audit evidence, and, in that case, the auditor should conclude that management's plans are insufficient to alleviate the determination that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time. Paragraphs .A32-.A38 of AU-C section 570 provide additional information, including an example third-party support letter, related to this requirement.

Consideration of Conditions and Events

The following list includes examples of adverse conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern for a reasonable amount of time in audits of gaming entities:

- *Negative financial trends*—for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, other adverse key financial ratios.
- *Other indications of possible financial difficulties*—for example, default on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, need to restructure debt to avoid default, noncompliance with statutory capital requirements, need to seek new sources or methods of financing or to dispose of substantial assets.
- *Internal matters*—for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, need to significantly revise operations.
- *External matters*—for example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood; concerns expressed or actions taken by regulatory authorities regarding alleged unsafe or unsound practices; indications of strained relationships between management and regulatory authorities.

The existence of one or more of the conditions or events noted here does not establish that there is substantial doubt about an entity's ability to continue

as a going concern. Similarly, an absence of these conditions or events does not establish that there is no substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Determining whether there is substantial doubt depends on an assessment of relevant conditions and events, in the aggregate, that are known and reasonably knowable at the date the financial statements are issued, or when applicable, available to be issued.

Auditor Conclusions

Adequacy of Disclosures

Pursuant to paragraph .21 of AU-C section 570, if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time, the auditor should evaluate the adequacy of the financial statement disclosures as required by the applicable financial reporting framework. Note that some financial reporting frameworks provide explicit requirements about financial statement disclosures.

If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans, the auditor should evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework. See paragraph .A45–.A47 of AU-C section 570 for additional information.

Implications for the Auditor's Report

Pursuant to paragraph .23 of AU-C section 570, if the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor should express an adverse opinion. If, after considering identified conditions or 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 auditor should include an emphasis-of-matter paragraph in the auditor's report. The emphasis-of-matter paragraph about the entity's ability to continue as a going concern for a reasonable period of time should be expressed through the use of terms consistent with those included in the applicable financial reporting framework. In a going concern emphasis-of-matter paragraph, the auditor should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

If adequate disclosure about an entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the auditor should express a qualified opinion or adverse opinion, as appropriate, in accordance with AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*).

Communicate With Those Charged With Governance

Pursuant to paragraph .28 of AU-C section 570, unless all those charged with governance are involved in managing the entity, the auditor should communicate with those charged with governance regarding conditions and events,

considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Such communication with those charged with governance should include the following:

- Whether the conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time constitute substantial doubt
- The auditor's consideration of management's plans
- Whether management's use of the going concern basis of accounting, when relevant, is appropriate in the preparation of the financial statements
- The adequacy of related disclosures in the financial statements
- The implications for the auditor's report

Documentation

13.175 Paragraph .22 of AU-C section 570A states that if the auditor believes, before consideration of management's plan, there is substantial doubt about the entity to continue as a going concern for a reasonable time, the auditor should document the following:

- a. The conditions or events that led the auditor to believe that there is substantial doubt 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 to evaluate the significant elements of management's plans and evidence obtained.
- d. The auditor's conclusion regarding 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, and, if applicable, the adequacy of, disclosure of the principal conditions and events that initially caused the auditor to believe there was substantial doubt.
- e. The auditor's conclusion with respect to the effects on the auditor's report.

Group Audit Engagements

13.176 Group audits involve the audit of financial statements that include the financial information of more than one component (group financial statements). An audit of group financial statements involves identifying the components that are part of the group and considering the effect of the components on the overall group audit strategy and group audit plan, including the extent to which the group engagement team will use the work of component auditors.

AU-C section 600 addresses special considerations that apply to group audits, in particular those that involve component auditors. The applicability of AU-C section 600 depends on whether more than one component is identified, regardless of whether there is another auditor involved.

13.177 Under AU-C section 600, the group engagement team is required, among other things, to

- obtain an understanding of the group, its components, and their environments including group-wide controls.
- establish a group audit strategy.
- develop a group audit plan.

13.178 AU-C section 600 applies to group audits, specifically,

- paragraphs .13–.26 and paragraphs .32–.50 of AU-C section 600 apply to all group audits.
- additional requirements in paragraphs .27–.30 of AU-C section 600 apply when the group engagement partner decides to make reference to the audit of a component auditor in the auditor's report on the group financial statements.
- additional requirements in paragraph .31 and paragraphs .51–.65 of AU-C section 600 apply when the auditor assumes responsibility for the work of a component auditor.

Definition of a Component

13.179 A *component* is an entity or business activity for which group or component management prepares financial information that is required to be included in the group financial statements. A component may include, but is not limited to, subsidiaries, geographical locations, divisions, investments, products or services, functions, or processes. Components in a gaming entity may correspond to the types of services offered depending upon whether or not these services are accounted for as centralized or decentralized activities. Examples of these services or activities might include food and beverage or the gaming hotel or resort.

13.180 The term *component* used in applying the provisions of AU-C section 600 is different from the term *component unit* as defined by GASB. GASB defines *component units* as legally separate organizations for which elected officials of the government are financially accountable, and provides for the inclusion of these organizations as *component units* in the basic financial statements of a primary government where appropriate. Although a *component unit*, as defined by GASB, may meet the definition of a *component* under AU-C section 600, the governmental gaming entity may include additional components because the definition of a *component* under AU-C section 600 is much broader than the definition of a *component unit*.

Group Audit Technical Practice Aid

13.181 Q&A section 8800, *Audits of Group Financial Statements and Work of Others (AICPA Technical Questions and Answers)*, provides technical answers to common group audit questions.

Other Information, Supplementary Information, and Required Supplementary Information

13.182 A gaming entity may publish various documents that contain information in addition to audited financial statements and the auditor's report thereon. AU-C section 720, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*), addresses the auditor's responsibility with respect to other information in documents containing audited financial statements and the auditor's report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the financial statements does not cover other information, and the auditor has no responsibility for determining whether such information is properly stated. AU-C section 720 establishes the requirement for the auditor to read the other information of which the auditor is aware because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information.

13.183 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-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*), addresses the auditor's responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. The information covered by AU-C section 725 is presented outside the basic financial statements and is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. AU-C section 725 may also be applied, with the report wording adapted as necessary, when an auditor has been engaged to report on whether required supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

13.184 AU-C section 730, *Required Supplementary Information* (AICPA, *Professional Standards*), addresses the auditor's responsibility with respect to information that a designated accounting standards setter requires to accompany an entity's basic financial statements (hereinafter referred to as *required supplementary information*). In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the basic financial statements does not cover required supplementary information.

13.185 The auditor's responsibilities related to RSI and to supplementary information other than RSI as specified by GASB, and the auditor's responsibilities for reporting on that information, is discussed in the Audit and Accounting Guide *State and Local Governments*.

13.186 Refer to appendix C, "Illustrative Financial Statements," of this guide for illustrative financial statements and 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," 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 14.37–44.

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, careful planning of the auditor's observation of the count procedures is needed. In addition, it is important to know the types of items that constitute the total cage accountability, their locations, and the custodians. With this information, the auditor determines if any cash in the casino cage is not included in the cage accountability.

14.09 In order to simultaneously control all material components of the accountability until they are counted, the number of auditors assigned to a cash count is also a consideration during the planning of the casino count procedures.

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 are typically examined on a test basis and totaled. Checks for deposit are 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, testing of the proceeds of gaming activities for the final shift on the count date is needed to establish the existence of the cash and markers. Furthermore, it is important to verify that proceeds of gaming activities not included in the casino cage accountability are not used to cover a shortage. See paragraph 14.08.

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. For instance, it typically takes several hours to remove the contents of all gaming devices and to remove drop boxes at table games. 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 is needed 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 when testing the proper cutoff of marker balances involves 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.

14.19 In the case of voucher-operated gaming devices, a voucher is printed and received by the customer for the amounts due to the customer. The customer may immediately redeem the voucher or may choose to retain the voucher for some future use or redemption. The gaming entity's record/evidence of the voucher issued is maintained electronically rather than in physical form resulting in a computer system dependency for accuracy, completeness, cutoff, and other key audit assertions around the issuance of such vouchers. The auditor considers the form and extent of audit evidence needed when testing the amount of vouchers issued. Audit procedures may include tests of controls over computer systems and interfaces, systems logic and data testing, auditor initiated transactions, or some combination of these procedures.

Other Games

14.20 Keno and bingo cutoff testing typically includes observation of the 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.

14.21 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.

14.22 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.

Online Gaming

14.23 The nature of online gaming results in transactions that occur electronically with no physical documentation created or maintained regarding the individual transactions, or the net outcome of such transactions. The gaming

entity and the auditor are dependent on computer systems and interfaces for each of the key audit assertions related to these transactions. The auditor considers the form and extent of audit evidence needed when testing the amounts reported by the online gaming systems. Audit procedures may include tests of controls over computer systems and interfaces, systems logic and data testing, auditor initiated transactions, or some combination of these procedures.

Drop and Count Procedures

14.24 The drop and count of proceeds for the final shift proceeding the cut-off 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 would consider testing the machine's accuracy, although regulations regarding such testing may apply.
- 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.

14.25 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.

14.26 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.

14.27 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 would consider testing the accuracy of the count machines or weighing devices. Consideration is also given to the effectiveness of the procedures in place to ensure the segregation of any other funds present in the count room from gaming device proceeds.

Receivables

Background

14.28 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.

14.29 Although the characteristics of the gaming industry may sometimes necessitate the use of innovative methods to attain audit satisfaction, these characteristics do not reduce the consideration of the external confirmation of receivables or reduce the auditor's responsibility for satisfying himself or herself concerning the existence and collectability of receivables.

14.30 As part of the audit, an understanding of the gaming entity's policies for granting credit and the regulatory requirements in the jurisdiction is needed. 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.

14.31 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.

External Confirmation of Gaming Receivables

14.32 AU-C section 505, *External Confirmations* (AICPA, *Professional Standards*), provides guidance that addresses the auditor's use of external confirmation procedures to obtain audit evidence, in accordance with the requirements of AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AICPA, *Professional Standards*), and AU-C section 500, *Audit Evidence* (AICPA, *Professional Standards*). Depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. AU-C section 505 is intended to assist the auditor in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.

14.33 Paragraph .03 of AU-C section 505 states that the auditor is required to consider whether external confirmation procedures are to be performed as substantive audit procedures and is required to use external confirmation procedures for accounts receivable unless the overall account balance is immaterial; external confirmation procedures would be ineffective; or the auditor's assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk. Because of the sensitivity around gaming markers, an auditor may conclude that the response rate to external confirmations will be inadequate based upon the auditor's experience on that engagement or on similar engagements.

14.34 Paragraph .12 of AU-C section 505 states that in the case of each nonresponse, the auditor should perform alternative audit procedures to obtain relevant and reliable audit evidence. Such alternative procedures might include the inspection of markers in the cage, verifying the date the markers were issued.

14.35 The nature and extent of alternative procedures are affected by the account and assertion in question as stated in paragraph .A24 of AU-C section 505. Examples of alternative audit procedures the auditor may perform include the following:

- For accounts receivable balances, examining specific subsequent cash receipts (including matching such receipts with the actual items being paid), shipping documentation, or other client documentation providing evidence for the existence assertion
- For accounts payable balance, examining subsequent cash disbursements or correspondence from third parties and other records, such as receiving reports and statements that the client receives from vendors providing evidence for the completeness assertion

14.36 For additional alternative procedures see paragraph 14.45. Additionally, paragraph .A25 of AU-C section 505 states that a nonresponse to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level and modify planned audit procedures, in accordance with AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*).

14.37 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 external 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 external confirmation date. Care is exercised by the auditor to ensure a proper cutoff of receivables and any related chips and cash.

14.38 Factors that affect the nature, timing, and extent of external 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. Because controls may be different for each area, the effectiveness of controls for each area is 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.* External 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.

14.39 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 the audit. Because the response to positive external confirmation of transactions and account balances might be low, alternative methods of determining the existence and proper valuation of gaming receivables may be needed.

14.40 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.

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

Mail Circularization

14.42 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, the casino employees and the auditors will usually mutually determine whether mail is sent to the customer's home or to his or her business address. For the auditor to satisfy himself or herself about the validity of the address and to reduce the number of external confirmation requests returned by the postal service, he or she may consider independent substantiation of the address by use of the telephone directory or a name-to-address cross-reference directory, by use of registered mail, or other means which may include use of the Internet. For foreign residents, the auditor may consider applicable postal service procedures, such as whether undeliverable mail is returned to its sender.

Oral Responses

14.43 Paragraph .A27 of AU-C section 505 states that an oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor. Provided that the

auditor has not concluded that a direct written response to a positive confirmation is necessary to obtain sufficient appropriate audit evidence, the auditor may take the receipt of an oral response to a confirmation request into consideration when determining the nature and extent of alternative audit procedures required to be performed for nonresponses, in accordance with paragraph .12 of AU-C section 505. The auditor may perform additional procedures to address the reliability of the evidence provided by the oral response, such as initiating a call to the respondent using a telephone number that the auditor has independently verified as being associated with the entity.

14.44 The auditor may determine that the additional evidence provided by contacting the respondent directly, together with the evidence upon which the original confirmation request is based (for example, a statement or other correspondence received by the entity), is sufficient appropriate audit evidence. In appropriately documenting the oral response, the auditor may include specific details, such as the identity of the person from whom the response was received, his or her position, and the date and time of the conversation.

Alternative Procedures When No Reply Is Received

14.45 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 external 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 the auditor is on the client's premises so that he or she may observe the collection.

Branch Offices

14.46 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 casino 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 marker 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 visit to selected branch offices is generally 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 include tests of cash on hand and in banks. In addition, the auditor may test controls related to collection procedures, marker safekeeping, and communication of significant credit data between the branch and the casino.

Allowance for Doubtful Accounts

14.47 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, is an important consideration when the auditor evaluates the collectability of markers.

14.48 Practices used in establishing allowances for doubtful accounts include (a) review of individual accounts; (b) use of aging criteria (for example, automatic inclusion of account balances in the allowance when a specified age is reached,² 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

14.49 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

14.50 In audits of other types of entities, the extent of actual observation of routine operations and corroborative inquiries may 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 the testing of the internal controls not involving a trail of documentary evidence is usually greater than in most other audits.

14.51 Because the auditor's tests of controls are performed to determine whether the controls are actually operating effectively, it is important that the

² The effects on aging when current markers merely replace older ones is a consideration when testing.

observation of gaming floor operations is not announced in advance, and some phases of the observation may be undisclosed. In a similar fashion, it is important that observations of operations in the cage and count room are not announced in advance even though security procedures will usually prevent them from being undisclosed. However, regulation may apply regarding unannounced observations.

14.52 In addition, observations carried out at various times throughout the period under audit is the recommended approach. Furthermore, obtaining letters of introduction to gaming personnel, and arranging for prompt access to restricted areas during such visits, will assist in maintaining the element of surprise. The precise number of visits is a matter of the auditor's professional judgment. However, the length and frequency of observation normally exceed those in audits of entities in other industries in order to provide the auditor with reasonable assurance that control activities relevant to the audit were applied as prescribed during the period under audit.

Chapter 15

Internal Control¹

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*² 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 are typically 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

¹ The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control—Integrated Framework (Framework)*, first developed in 1992, is one of the most widely accepted frameworks for designing and evaluating systems of internal control. This framework was updated in 2013 to make it more relevant in the current business environment—one that has become more complex and technologically driven in the 20 years since the original framework was established. Although the updated framework does not alter the fundamental principles found in the original framework, it builds on what has proven effective in the original framework. This publication is available at www.coso.org.

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

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.

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 necessary to establish or increase credit lines.
- Credit files indicate an approved credit limit.
- Credit files are periodically reviewed for the completeness of necessary information, and established 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 oversight, 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 is performed periodically 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. Authorization by additional officials may be needed for 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 is subject to automatic recording of the numbers selected from the random number generator into the computerized bingo system to prevent bingo personnel 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 *Customer wagering accounts*

- Controls exist to ensure that establishment of a customer wagering account is authorized in accordance with the system.
- Procedures exist to obtain an identification credential from an applicant; and record information, such as name, address, and applicant's signature.
- Customer's account transactions are accurately recorded.
- The integrity of the customer's files is protected, and the data are sufficiently reviewed to ensure proper recording of additions and deletions and to preclude unauthorized alteration of information and account transactions.
- Access to critical forms, records, and processing areas is permitted only in accordance with established criteria.

- Procedures exist to provide a secure method for a customer to access funds.
- Wagering account balances are reconciled to account transactions activity at least daily.

15.22 *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

15.23 *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.

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

15.25 *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

15.26 *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

15.27 *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.

15.28 *User controls*

- Unique passwords are assigned to each individual using the system unless user access is restricted to inquiry-only functions.
- Use of system passwords meet the following:
 - Are changed at least once every 90 days
 - At least 8 characters in length and contains a combination of at least 2 of the following criteria: upper case letters, lower case letters, numeric, or special characters
 - Not reused for a period of 18 months, or passwords may not be re-used within the last 10 password changes
 - User accounts are automatically locked out after 3 failed login attempts
- Terminated employees do not have access to the system.
- Management personnel, or persons independent of the department being controlled, establish, or review and approve, user accounts for new employees.
- Management personnel, or persons independent of the department being controlled, establish, or review and approve, changes made to a user's previously assigned application function access.
- Access to administer the network, operating system, applications, and database security and system parameters is limited to authorized IT personnel.

15.29 *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.

15.30 *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

15.31 *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. Signatures of two individuals (a supervisor and the writer of the ticket) are needed on 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.

15.32 *Number selection*

- The number selection process is monitored and filmed by camera both prior to and subsequent to the calling of a game and typically 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 needed 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 is subject to automatic recording of the numbers selected from the random number generator into the computerized keno system to prevent Keno personnel from changing the numbers selected.
- Keno personnel are precluded access to the random number generator.

15.33 *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 needed for the payment on tickets that are not authorized through the computerized keno system.

15.34 *Keno funds*

- The computerized keno system indicates the amount of net cash expected to be in the writer or cashier bank at the end of a shift. A supervisor is generally the individual with access to 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

15.35 *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.

15.36 *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.

15.37 *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

15.38 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)

15.39 *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.

15.40 *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.

15.41 *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.

15.42 *Race and sports funds*

- The computerized race and sports system indicates the amount of net cash expected to be in the writer or cashier bank at the end of a shift. A supervisor is generally the individual with access to 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.

15.43 *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

15.44 *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 are 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 is 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 is 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.

15.45 *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 are 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.

15.46 *Count procedures (applies to both scheduled and unscheduled counts)*

- Physical safeguards present:
 - Surveillance monitoring of the drop and count processes.
 - When coin buckets and currency acceptor boxes are removed from the slot machine, an observer independent of the slot department is present.
 - 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.

15.47 *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 needed for account redemptions.
- Access to inactive and closed accounts is restricted to authorized supervisory personnel.

15.48 *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.

15.49 *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

15.50 *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 are 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 is 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 is 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.

15.51 *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.

15.52 *Count procedures (applies to both scheduled and unscheduled drops and counts)*

- Physical safeguards present:
 - Surveillance monitoring of the drop and count processes.
 - When a table game drop box is removed from or placed in a storage rack, an observer independent of the pit department is present.

- 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.

15.53 *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.
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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.

16.02 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 are typically investigated. To facilitate prompt investigation, the auditor may consider regularly communicating with the gaming entity's management during the year.

16.03 Some regulatory bodies may require the performance of analytical review procedures on a periodic basis, along with the subsequent documentation of all findings. A review of client-prepared documentation may aid in the auditor's performance of analytical review procedures.

16.04 For specific auditing guidance relating to analytical procedures refer to chapter 13, "General Auditing Considerations."

Types of Analytical Procedures

16.05 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 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

16.06 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 (often in combination with tests of controls) because there is a lack of customer documentation regarding gross gaming revenue. 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 be identified during the performance of analytical procedures relating to unusual losses and unusual hold percentages (commonly referred to as *underholding* and *overholding variances*) which could indicate the need to perform further testing. In addition, the procedures may provide an indication of a material misstatement due to fraudulent financial reporting.

16.07 Some sample factors for management or auditors, or both, that they may 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 type or denomination or both)
 - 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

¹ See the "Overview of Transactions in the Casino and the Casino Cage" section in chapter 3, "Overview of Gaming and Gaming Related Revenue," of this guide, 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.

- 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
 - Special events
 - Local economic conditions

16.08 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

16.09 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

16.10 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.

16.11 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.

16.12 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.

Appendix A

Category B Guidance

This appendix is nonauthoritative and is included for informational purposes only.

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, establishes the hierarchy of generally accepted accounting principles (GAAP) for state and local governments. The GAAP hierarchy consists of sources of accounting principles used in the preparation of financial statements so that they are presented in accordance with GAAP and the framework for selecting those principles. Sources of category B guidance include AICPA literature specifically made applicable to state and local governmental entities and cleared by GASB, such as certain provisions in this guide. This appendix lists the category B guidance that is included in this guide. Category B guidance appears in orange font in this guide.

Location	Nature of Guidance	GASB Codification Reference 2017–18
Paragraph 3.01	Description of <i>gaming activities</i>	P80.811, Sp20.805
Paragraph 3.02	Description of <i>gaming related activities</i>	P80.812, Sp20.806
Paragraph 3.03	Description of win or loss based on factors other than the outcome of the game	P80.813, Sp20.807
Paragraph 3.04	Activities that are neither gaming activities nor gaming related activities	P80.814, Sp20.808
Paragraph 3.05	Measurement of revenue recognized by casinos	P80.815, Sp20.809
Paragraph 3.06	Net versus gross revenue recognition by state lotteries	P80.816, Sp20.810
Paragraph 3.07	Description of <i>gross gaming revenue</i>	P80.817, Sp20.811
Paragraph 3.07 footnote 2	The reporting of gross versus net gaming revenue in external financial statements	P80.817, Sp20.811
Paragraph 3.09	Description of <i>net gaming revenue</i>	P80.818, Sp20.812
Paragraph 3.10	The reporting of prizes and payouts resulting from banked games	P80.819, Sp20.813
Paragraph 3.11	The reporting of prizes directly funded by tournament members	P80.820, Sp20.814

(continued)

<i>Location</i>	<i>Nature of Guidance</i>	<i>GASB Codification Reference 2017-18</i>
Paragraph 3.12	The reporting of net profit or loss when the gaming entity has no gaming risk but has business risk	P80.821, Sp20.815
Paragraph 3.13	The circumstances for reporting prizes as marketing or promotional expense rather than net gaming revenue	P80.822, Sp20.816
Paragraphs 12.20-.22	Indicators of impairment of a governmental gaming entity's capital assets	1400.801-.803

Appendix B

The New Revenue Recognition Standard: FASB ASC 606

This appendix is nonauthoritative and is included for informational purposes only.

Overview

On May 28, 2014, the International Accounting Standards Board (IASB) and FASB issued a joint accounting standard on revenue recognition to address a number of concerns regarding the complexity and lack of consistency surrounding the accounting for revenue transactions. Consistent with each board's policy, FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and the IASB issued International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers*. FASB ASU No. 2014-09 will amend the FASB Accounting Standards Codification[®] (ASC) by creating a new Topic 606, *Revenue from Contracts with Customers*, and a new Subtopic 340-40, *Other Assets and Deferred Costs—Contracts with Customers*. The guidance in ASU No. 2014-09 provides what FASB describes as a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics.

As part of the boards' efforts to converge U.S. generally accepted accounting principles (GAAP) and IFRSs, the standard eliminates the transaction- and industry-specific revenue recognition guidance under current GAAP and replaces it with a principles-based approach for revenue recognition. The intent is to avoid inconsistencies of accounting treatment across different geographies and industries. In addition to improving comparability of revenue recognition practices, the new guidance provides more useful information to financial statement users through enhanced disclosure requirements. FASB and the IASB have essentially achieved convergence with these standards, with some minor differences related to the collectibility threshold, interim disclosure requirements, early application and effective date, impairment loss reversal, and non-public entity requirements.

The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

Effective or Applicability Date

The guidance in ASU No. 2014-09 was originally effective for annual reporting periods of public entities beginning after December 15, 2016, including interim periods within that reporting period. Early application was not permitted for public entities, including not-for-profit entities (NFPs) that have issued, or are

conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market and for employee benefit plans that file or furnish financial statements to the SEC.

For nonpublic entities, the amendments in the new guidance were originally effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018.

On August 12, 2015, FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, to allow entities additional time to implement systems, gather data, and resolve implementation questions. This update allows for public business entities, certain NFPs, and certain employee benefit plans to apply the new requirements to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

All other entities will now apply the guidance in ASU No. 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Application is permitted earlier only as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period, or an annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which an entity first applies the guidance in ASU No. 2014-09.

Overview of the New Guidance

The core principle of the revised revenue recognition standard is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those good or services.

To apply the proposed revenue recognition standard, ASU No. 2014-09 states that an entity should follow these five steps:

1. Identify the contract(s) with a customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations in the contract.
5. Recognize revenue when (or as) the entity satisfies a performance obligation.

Under the new standard, revenue is recognized when a company satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). See the following discussion of the five steps involved when recognizing revenue under the new guidance.

Understanding the Five-Step Process

Step 1: Identify the Contract(s) With a Customer

ASU No. 2014-09 defines a contract as "an agreement between two or more parties that creates enforceable rights and obligations." The new standard affects contracts with a customer that meet the following criteria:

- Approval (in writing, orally, or in accordance with other customary business practices) and commitment of the parties
- Identification of the rights of the parties
- Identification of the payment terms
- Contract has commercial substance
- Probable that the entity will collect substantially all the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer

A contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (parties).

Step 2: Identify the Performance Obligations in the Contract

A *performance obligation* is a promise in a contract with a customer to transfer a good or service to the customer.

At contract inception, an entity should assess the goods or services promised in a contract with a customer and identify as a performance obligation (possibly multiple performance obligations) each promise to transfer to the customer either

- a good or service (or bundle of goods or services) that is distinct, or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A good or service that is not distinct should be combined with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

Step 3: Determine the Transaction Price

The transaction price is the amount of consideration (fixed or variable) the entity expects to receive in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. To determine the transaction price, an entity should consider the effects of

- variable consideration,
- constraining estimates of variable consideration,
- the existence of a significant financing component,
- noncash considerations, and
- consideration payable to the customer.

If the consideration promised in a contract includes a variable amount, then an entity should estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. An entity would then include in the transaction price some or all of an amount of variable consideration only to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

An entity should consider the terms of the contract and its customary business practices to determine the transaction price.

Step 4: Allocate the Transaction Price to the Performance Obligations in the Contract

The transaction price is allocated to separate performance obligations in proportion to the standalone selling price of the promised goods or services. If a standalone selling price is not directly observable, then an entity should estimate it. Reallocation of the transaction price for changes in the standalone selling price is not permitted. When estimating the standalone selling price, entities can use various methods, including the adjusted market assessment approach, expected cost plus a margin approach, and residual approach (only if the selling price is highly variable and uncertain).

Sometimes, the transaction price includes a discount or a variable amount of consideration that relates entirely to one of the performance obligations in a contract. Guidance under the new standard specifies when an entity should allocate the discount or variable consideration to one (or some) performance obligation(s), rather than to all the performance obligations in the contract.

Step 5: Recognize Revenue When (or as) the Entity Satisfies a Performance Obligation

The amount of revenue recognized when transferring the promised good or service to a customer is equal to the amount allocated to the satisfied performance obligation, which may be satisfied at a point in time or over time. Control of an asset refers to the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset. Control also includes the ability to prevent *other entities* from directing the use of, and obtaining the benefits from, an asset.

When performance obligations are satisfied over time, the entity should select an appropriate method for measuring its progress toward complete satisfaction of that performance obligation. The standard discusses methods of measuring progress, including input and output methods, and how to determine which method is appropriate.

Additional Guidance Under the New Standard

In addition to the five-step process for recognizing revenue, ASU No. 2014-09 also addresses the following areas:

- Accounting for incremental costs of obtaining a contract, as well as costs incurred to fulfill a contract
- Licenses
- Warranties

Lastly, the new guidance enhances disclosure requirements to include more information about specific revenue contracts entered into by the entity, including performance obligations and the transaction price.

Transition Resource Group

Due to the potential for significant changes that may result from the issuance of the new standard, FASB and the IASB have received an abundance of implementation questions from interested parties. To address these questions, the boards have formed a joint Transition Resource Group (TRG) for revenue recognition to promote effective implementation and transition to the converged standard.

Since the issuance of the standard, the TRG has met several times to discuss implementation issues raised by concerned parties and actions to take to address these issues. Refer to FASB's TRG website for more information on this group and the status of their efforts, including meeting materials and meeting summaries.

Latest Developments

Based on discussions held thus far on individual areas affected by the new standard, the TRG informed the boards that technical corrections are needed to further articulate the guidance in the standard. As a result, FASB has issued updates to clarify guidance on performance obligations, licensing, principal versus agent considerations, and other narrow-scope improvements and practical expedients.

ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principle versus Agent Considerations (Reporting Revenue Gross versus Net)*, was issued in March 2016 to clarify the guidance in FASB ASC 606 with respect to principal versus agent. There is little disagreement that an entity who is a principal recognizes revenue in the gross amount of consideration when a performance obligation is satisfied. An entity who is an agent (collecting revenue on behalf of the principal) recognizes revenue only to the extent of the commission or fee that the agent collects. This ASU hopes to eliminate the potential diversity in practice when determining whether an entity is a principal or an agent by clarifying the following:

- An entity determines whether it is a principal or an agent for each distinct good or service.
- An entity determines the nature of each specified good or service (including whether it is a right to a good or service)
- When an entity is a principal, it obtains control of
 - a good or another asset from the other party that it then transfers to the customer;
 - a right to a service that will be performed by another party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf; or

- a good or service from the other party that it combines with other goods or services to provide the specified good or service to the customer.
- Indicators in the assessment of control may be more or less relevant or persuasive, or both, to the control assessment, depending on the facts and circumstances.

Additional illustrative examples are also provided in ASU No. 2016-08 to further assist practitioners in applying this guidance. The effective date of this update is in line with the guidance in ASU No. 2014-09, as amended by ASU No. 2015-14.

ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, was issued in April 2016 to reduce potential for diversity in practice at initial application of FASB ASC 606, as well as the cost and complexity of applying FASB ASC 606 at transition and on an ongoing basis. When identifying promised goods and services in a contract, this ASU states that entities

- are not required to assess whether promised goods or services are performance obligations if they are immaterial to the contract.
- can elect to account for shipping and handling activities as an activity to fulfill promises within the contract, rather than as an additional promised service.

When assessing whether promised goods or services are distinct, this ASU emphasizes the need to determine whether the nature of the promise is to transfer

- each of the goods or services, or
- a combined item (or items) to which the promised goods or services are inputs.

With regards to licensing, ASU No. 2016-10 clarifies whether revenue should be recognized at a point in time or over time, based on whether the license provides a right to use an entity's intellectual property or a right to access the entity's intellectual property. Specifically,

- if the intellectual property has significant standalone functionality, the license does not include supporting or maintaining that intellectual property during the license period. Therefore, the performance obligation would be considered satisfied at a point in time. Examples of this type of intellectual property include software, biological compounds or drug formulas, and media.
- licenses for symbolic intellectual property include supporting or maintaining that intellectual property during the license period and, therefore, are considered to be satisfied over time. Examples of symbolic intellectual property include brands, team or trade names, logos, and franchise rights.

Lastly, ASU No. 2016-10 provides clarification on implementation guidance on recognizing revenue for sales-based or usage-based royalty promised in exchange for a license of intellectual property. The effective date of this ASU is in line with the guidance in ASU No. 2014-09, as amended by ASU No. 2015-14.

In addition to ASU Nos. 2016-08 and 2016-10, ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, was issued in May 2016. Topics covered in this ASU include

- clarification on contract modifications. This amendment permits an entity to determine and allocate the transaction price on the basis of all satisfied and unsatisfied performance obligations in a modified contract as of the beginning of the earliest period presented in accordance with the guidance in FASB ASC 606. An entity would not be required to separately evaluate the effects of each contract modification. An entity that chooses to apply this practical expedient would apply the expedient consistently to similar types of contracts.
- how to assess the collectibility criterion. The amendment introduces new criteria to meet the collectibility requirement. An entity should assess the collectibility of the consideration promised in a contract for the goods or services that will be transferred to the customer, rather than assessing the collectibility of the consideration promised in the contract for all the promised goods or services.
- how to report sales taxes and similar taxes. This amendment states that an entity may make an accounting policy election to exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer (for example, sales, use, value added, and some excise taxes). Taxes assessed on an entity's total gross receipts or imposed during the inventory procurement process should be excluded from the scope of the election. An entity that makes this election should exclude from the transaction price all taxes in the scope of the election and should comply with the applicable accounting policy guidance, including disclosure requirements.
- when to measure noncash consideration. This amendment clarifies that the measurement date for noncash consideration is contract inception. If the fair value of the noncash consideration varies because of the form of the consideration and for reasons other than the form of the consideration, an entity should apply the guidance on variable consideration only to the variability resulting from reasons other than the form of the consideration.
- how to apply transition guidance. This amendment clarifies that a completed contract for purposes of transition is a contract for which all (or substantially all) the revenue was recognized under legacy GAAP before the date of initial application. Accounting for elements of a contract that do not affect revenue under legacy GAAP are irrelevant to the assessment of whether a contract is complete. In addition, the amendment permits an entity to apply the modified retrospective transition method either to all contracts or only to contracts that are not completed contracts.

The effective date of this ASU is in line with the guidance in ASU No. 2014-09, as amended by ASU No. 2015-14.

FASB also issued ASU No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, in December 2016. These amendments affect narrow aspects of guidance issued in ASU No. 2014-09, including but not limited to, guidance on

- impairment testing. When performing impairment testing, an entity should consider expected contract renewals and extensions. In addition, the assessment should include both the amount of consideration it already has received but has not yet recognized as revenue, and the amount it expects to receive in the future.
- additional scope exceptions. The term "insurance" is removed from the scope exceptions of FASB ASC 606 to clarify that all contracts within the scope of FASB ASC 944, *Financial Services—Insurance*, are excluded.
- provisions for losses on construction-type and production-type contracts. Such provisions should be determined at least at the contract level; however, an entity can make an accounting policy election to determine the provision for losses at the performance obligation level.
- disclosure of remaining performance obligations. Optional exemptions from the disclosure requirement are provided for remaining performance obligations when an entity is not required to estimate variable consideration to recognize revenue.

Consistent with the other ASUs, the effective date of ASU No. 2016-20 is in line with the guidance in ASU No. 2014-09, as amended by ASU No. 2015-14.

In February 2017, the FASB issued ASU No. 2017-05, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*. The amendments in this ASU include, but are not limited to

- a definition of the term in substance nonfinancial asset, to clarify the scope of FASB ASC 610-20. An in substance nonfinancial asset is, in part, a financial asset promised to a counterparty in a contract if substantially all of the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in the contract is concentrated in nonfinancial assets. An in substance nonfinancial asset also includes a financial asset that is held in an individual consolidated subsidiary within a contract if substantially all the fair value of the assets (recognized and unrecognized) that are promised to the counterparty in that subsidiary is concentrated in nonfinancial assets.
- a clarification that nonfinancial assets within the scope of FASB ASC 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty. For example, a parent may transfer control of nonfinancial assets by transferring ownership interests in a consolidated subsidiary. A contract that includes the transfer of ownership interests in one or more consolidated subsidiaries is within the scope of Subtopic 610-20 if substantially all of the fair value of the assets that are promised to the counterparty in a contract is concentrated in nonfinancial assets.

- removal of the scope exception for transfers of equity method investment that were considered in substance nonfinancial assets. All transfers of equity method investments will be accounted for in accordance with FASB ASC 860, *Transfers and Servicing*.
- derecognition of each distinct nonfinancial asset or in substance nonfinancial asset promised to a counterparty. Each asset will be derecognized when a counterparty obtains control of it. The amendments also clarify that an entity should allocate consideration to each distinct asset by applying the guidance in FASB ASC 606 on allocating the transaction price to performance obligations.
- partial sales transactions. An entity will derecognize a distinct nonfinancial asset or distinct in substance nonfinancial asset in a partial sale transaction when it (1) does not have (or ceases to have) a controlling financial interest in the legal entity that holds the asset in accordance with FASB ASC 810, *Consolidation*, and (2) transfers control of the asset in accordance with FASB ASC 606. Once an entity transfers control of a distinct nonfinancial asset or distinct in substance nonfinancial asset, it is required to measure any noncontrolling interest it receives (or retains) at fair value. If an entity transfers ownership interests in a consolidated subsidiary and continues to have a controlling financial interest in that subsidiary, it does not derecognize the assets and liabilities of the subsidiary and accounts for the transaction as an equity transaction. Therefore, no gain or loss is recognized.
- contributions of nonfinancial assets to a joint venture or other non-controlled investee. These contributions will be within the scope of FASB ASC 610-20, and an entity will recognize a full gain or loss on transfers of nonfinancial assets to equity method investees.

Consistent with the other ASUs, the effective date of ASU No. 2017-05 is in line with the guidance in ASU No. 2014-09, as amended by ASU No. 2015-14.

Conclusion

Upon implementation of the new standard, consistency of revenue recognition principles across geography and industry will be enhanced and financial statement users will be provided better insight through improved disclosure requirements. To provide CPAs with guidance during this time of transition, the AICPA's Financial Reporting Center (FRC) offers invaluable resources on the topic, including a roadmap to ensure that companies take the necessary steps to prepare themselves for the new standard. In addition, the FRC includes a list of conferences, webcasts, and other products to keep you informed on upcoming changes in revenue recognition. Refer to www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/revenuerecognition.aspx to stay updated on the latest information available on revenue recognition.

Appendix C

Illustrative Financial Statements

This appendix is nonauthoritative and is included for informational purposes only.

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 SEC-registrant financial statements should be aware that there may be certain disclosures required to be made in addition to those required by generally accepted accounting principles. Those additional requirements are not presented in these illustrative financial statements because they are not otherwise required by generally accepted accounting principles. In addition to the illustrative notes that are presented, the notes to financial statements of a casino should include any other appropriate disclosures required by generally accepted accounting principles, 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.

ABC Casinos, Inc.: 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 financial statements of ABC Casinos, Inc. as of December 31, 20X2 and 20X1, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes

in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.¹

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Casinos, Inc. as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

[Auditor's signature]

[Auditor's city and state]²

[Date of the auditor's report]

¹ According to footnote 1 to illustration 1 in the exhibit, "Illustrations of Auditor's Reports on Financial Statements," of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*), the subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For clarification regarding the naming of the city and state on the auditors report refer to Q&A section 9100.07, "Naming the City and State Where the Auditor Practices," and Q&A section 9100.08, "Audit Firm With Multiple Offices on Their Company Letterhead and Effect on the Report" (AICPA, *Technical Questions and Answers*).

ABC Casinos, Inc.
Balance Sheets

	<i>December 31,</i>	
	<i>20X2</i>	<i>20X1</i>
<i>Assets</i>		
<hr/>		
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
<hr/> <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 ³	450,075	375,000
Income taxes payable	150,000	161,000
Other	344,400	207,600
Total current liabilities	2,873,075	2,282,800
Long-term debt, less current portion	15,800,000	16,800,000
Deferred income taxes	618,125	501,000
Total liabilities	19,291,200	19,583,800
Stockholders' equity		
Common stock (\$1 par value 1,000,000 shares authorized, issued, and outstanding)	1,000,000	1,000,000
Capital in excess of par value	6,495,800	6,495,800
Retained earnings	12,616,000	11,529,415
Total stockholders' equity	20,111,800	19,025,215
Total liabilities and stockholders' equity	\$39,403,000	\$38,609,015

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

³ See update C-1, "Accounting and Reporting: Income Taxes," found in this appendix.

ABC Casinos, Inc.
Statements of Income and Retained Earnings

	<i>Year ended December 31,</i>	
	<u>20X2</u>	<u>20X1</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	1,000,000	900,000
	<u>20,003,200</u>	<u>17,999,500</u>
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	2,602,715	2,597,431
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 December 31,</i>	
	<u>20X2</u>	<u>20X1</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	(1,395,200)	(435,200)
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	(450,000)	(450,000)
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	3,787,100	1,159,500
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.

Ⓒ Update C-1 Accounting and Reporting: Income Taxes

FASB Accounting Standards Update (ASU) No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*, was issued in November of 2015.

The amendments in ASU No. 2015-17 are effective for public business entities' financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The amendments are effective for all other entities' financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Earlier application is permitted.

ASU No. 2015-17 applies to all entities that present a classified statement of financial position. The ASU amends FASB ASC 740 to require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. Readers are encouraged to consult the full text of this ASU on FASB's website at www.fasb.org.

**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 the value of loyalty credits.

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. Management fee revenue is 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, 20X2 and 20X1, 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, 20X2 and 20X1, respectively.

3. Accounts Receivable

Accounts receivable comprise the following:

	<i>Gaming</i>	<i>Other</i>	<i>Total</i>
<i>20X2</i>			
Accounts receivable	\$2,050,100	\$250,000	\$2,300,100
Less allowance for doubtful accounts	(440,000)	(60,000)	(500,000)
Net	<u>\$1,610,100</u>	<u>\$190,000</u>	<u>\$1,800,100</u>
<i>20X1</i>			
Accounts receivable	\$1,994,200	\$171,000	\$2,165,200
Less allowance for doubtful accounts	(431,000)	(39,000)	(470,000)
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:

	<i>20X2</i>	<i>20X1</i>
Rooms	\$1,000,000	\$900,000
Food and beverage	800,000	600,500
Other	309,400	357,900
Total	<u>\$2,109,400</u>	<u>\$1,858,400</u>

5. Long-Term Debt

Long-term debt is summarized as follows:

	<u>20X2</u>	<u>20X1</u>
Notes payable to banks, 1/4 to 3/4 over prime and 8% to 9%, payable in varying installments to 20X6	\$8,800,000	\$9,100,000
Notes payable to institutional lenders, 5 1/4% to 10 1/2%, payable to 20X6, of which \$11,786,000 is secured by real property	3,500,000	3,800,000
Notes payable, other, 1% over prime, payable to 20X6	<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><u>\$15,800,000</u></u>	<u><u>\$16,800,000</u></u>

The aggregate amounts of principal maturities of debt outstanding at December 31, 20X2, for the five subsequent years are as follows:

20X3	\$1,000,000
20X4	3,957,000
20X5	2,991,000
20X6	4,896,000
20X7	<u>3,956,000</u>
	<u><u>\$16,800,000</u></u>

6. Fair Value of Financial Instruments^{4,5}

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 (20X1, \$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 20X2, 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.

⁴ Readers may refer to 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.

⁵ 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.

XYZ Casino: Independent Auditor's Report

Independent Auditor's Report

XYZ Tribal Council

We have audited the accompanying financial statements of XYZ Casino (the Casino), an enterprise fund of the XYZ Tribe (the Tribe), which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of revenues, expenses, and changes in net position and cash flows and for the years then ended, and the related notes to the financial statements.⁶

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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.⁷ 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

⁶ See footnote 1.

⁷ 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*. AICPA Audit Guide *Government Auditing Standards and Single Audits* discusses *Government Auditing Standards* requirements and guidance related to financial audits. A practice aid, *2011 Yellow Book Independence—Non-audit Services Documentation Practice Aid*, has been developed by the AICPA Governmental Audit Quality Center (GAQC) to assist an auditor in evaluating non-audit services and the effect of performing such services on auditor independence under the 2011 revision. More information about the practice aid and how to obtain it can be found on the Resources page of the GAQC website at www.aicpa.org/gaqc.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

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, 20X2 and 20X1, and the changes in its financial position and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.⁸

Emphasis of Matter

As discussed in Note 1, the 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, 20X2 and 20X1, 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. Our opinion is not modified with respect to this matter.

Other Matters

Accounting principles generally accepted in the United States of America require that the [*identify the required supplementary information, such as management's discussion and analysis*] on pages XX–XX be presented to supplement the basic financial statements.⁹ Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

⁸ When required supplementary information (RSI) accompanies the entity's basic financial statements, the auditor should (a) express an opinion on whether the information is fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles if engaged to do so or (b) perform the required procedures in paragraphs .05–.06 of AU-C section 730, *Required Supplementary Information* (AICPA, *Professional Standards*), and report on such RSI using the guidance in paragraphs .07–.09 of AU-C section 730.

⁹ The governmental gaming entity illustrative financial statements in this appendix do not present illustrative management's discussion and analysis (MD&A) that would accompany the presented illustrative financial statements; however, such MD&A is RSI for governmental gaming entities, as discussed in chapter 12, "Governmental Gaming Entities," of this guide.

Gaming
XYZ Casino¹⁰
Balance Sheets¹¹

	<i>December 31,</i>	
	<i>20X2</i>	<i>20X1</i>
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	1,300,000	1,200,000
Total assets	<u>\$39,403,000</u>	<u>\$38,609,015</u>
Liabilities and Net Position		
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	<u>2,873,075</u>	<u>2,282,800</u>
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>
Net Position		
Invested in capital assets, net of related debt	13,583,900	14,197,615
Unrestricted	6,527,900	4,827,600
Total net position	<u>20,111,800</u>	<u>19,025,215</u>
Total liabilities and net position	<u>\$39,403,000</u>	<u>\$38,609,015</u>

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

¹⁰ As required by 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.

¹¹ Paragraph 8 of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, establishes the statement of net position should report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position in a format that displays assets, plus deferred outflows of resources, less liabilities, less deferred inflows of resources, equals net position (encouraged by GASB) or a balance sheet format. The balance sheet format is presented here, as it is the typical format used in the gaming industry.

XYZ Casino
Statements of Revenues, Expenses, and Changes in Net Position

	<i>For the Years Ended December 31,</i>	
	<u>20X2</u>	<u>20X1</u>
Operating Revenues ¹²		
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	<u>17,893,800</u>	<u>16,141,100</u>
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	<u>14,306,915</u>	<u>12,940,731</u>
Operating income	<u>3,586,885</u>	<u>3,200,369</u>
Nonoperating Revenues (Expenses)		
Interest expense	(2,050,300)	(1,935,300)
Total nonoperating revenues (expenses)	<u>(2,050,300)</u>	<u>(1,935,300)</u>
Income before transfers	1,536,585	1,265,069
Transfers to XYZ tribe ^{13,14}		
Gaming taxes and regulation	250,000	250,000
Other	200,000	200,000
	<u>450,000</u>	<u>450,000</u>
Change in net position	1,086,585	815,069
Net position, beginning of year	19,025,215	18,210,146
Net position, end of year	<u>\$20,811,800</u>	<u>\$19,025,215</u>

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

¹² See illustrative financial statements for nongovernmental entity for alternative acceptable presentation of promotional allowances.

¹³ GASB Statement No. 34 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.

¹⁴ 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 Flows¹⁵

	<i>For the Years Ended</i>	
	<i>December 31,</i>	
	<u>20X2</u>	<u>20X1</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	<u>(450,000)</u>	<u>(450,000)</u>
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	<u>(3,989,000)</u>	<u>(2,933,200)</u>
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>
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>

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

¹⁵ The direct method of presenting cash flows from operating activities is required by paragraph 105 of GASB Statement No. 34.

XYZ Casino
Notes to Financial Statements
December 31, 20X2 and 20X1

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.¹⁶

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

The financial statements of the Casino were prepared in accordance with accounting principles generally accepted in the United States of America for governmental entities (GAAP).

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.

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

¹⁶ This disclosure is not required for discretely presented component units.

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 that have a remaining maturity at the time of purchase, 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, 20X2 and 20X1, 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>	
	20X2	20X1
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, 20X2 and 20X1, 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:¹⁷

	<i>Gaming</i>	<i>Other</i>	<i>Total</i>
<u>20X2</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>20X1</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>20X2</u>	<u>20X1</u>
Notes payable to banks, 1/4–3/4 over prime and 8% to 9%, payable in varying installments to 20X6	\$8,800,000	\$9,100,000
Notes payable to institutional lenders, 5 1/4% to 10 1/2%, payable to 20X6	3,500,000	3,800,000
Notes payable, other, 1% over prime, payable to 20X6	<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	1,000,000	700,000
Net long-term debt	<u>\$15,800,000</u>	<u>\$16,800,000</u>

¹⁷ Paragraph 13 of 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.

The debt is reported by the Casino because it is directly related to and expected to be paid by the Casino.¹⁸

Changes in long-term debt for the years ended December 31, 20X2 and 20X1, are summarized as follows:

	<u>20X2</u>	<u>20X1</u>
Beginning balance	\$17,500,000	\$18,500,000
Additions	—	—
Reductions	700,000	1,000,000
Ending balance	<u>\$16,800,000</u>	<u>\$17,500,000</u>

Annual debt service requirements of long-term debt at December 31, 20X2, are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
20X3	\$1,000,000	\$1,141,000	\$2,141,000
20X4	3,957,000	967,505	4,924,505
20X5	2,991,000	724,325	3,715,325
20X6	4,896,000	448,280	5,344,280
20X7	3,956,000	138,460	4,094,460
	<u>\$16,800,000</u>	<u>\$3,419,570</u>	<u>\$20,219,570</u>

¹⁸ 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.

6. Capital Assets

Capital asset activity for the years ended December 31, 20X2 and 20X1, is summarized as follows:¹⁹

	<i>Year Ended December 31, 20X2</i>			
	<u><i>Beginning Balance</i></u>	<u><i>Increases</i></u>	<u><i>Decreases</i></u>	<u><i>Ending Balance</i></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>
	<i>Year Ended December 31, 20X1</i>			
	<u><i>Beginning Balance</i></u>	<u><i>Increases</i></u>	<u><i>Decreases</i></u>	<u><i>Ending Balance</i></u>
Land improvements	\$2,201,100	\$—	\$—	\$2,201,100
Buildings	27,602,300	—	—	27,602,300
Furniture and equipment	9,528,284	435,200	968,284	8,995,200
	<u>39,331,684</u>	<u>435,200</u>	<u>968,284</u>	<u>38,798,600</u>
Less: accumulated depreciation				
Land				
improvements	815,262	55,028	—	870,290
Buildings	3,481,112	690,057	—	4,171,169
Furniture and equipment	738,164	1,852,346	530,984	2,059,526
	<u>5,034,538</u>	<u>2,597,431</u>	<u>530,984</u>	<u>7,100,985</u>
Capital assets, net	<u>\$34,297,146</u>	<u>\$(2,162,231)</u>	<u>\$437,300</u>	<u>\$31,697,615</u>

¹⁹ 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.

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 D

Illustrative Guidance When Accounting for Guarantees

This appendix is nonauthoritative and is included for informational purposes only.

Applicability: *This appendix provides guidance applicable to nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB 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 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 assesses 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 multi-element 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 D-1

Year	<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 D-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 D-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 D-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.

In such circumstances, two transactions have occurred and are accounted for separately. The first transaction is the termination of the guarantee, similar to

¹ Pursuant to 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.

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.

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):

<i>Year</i>	<i>Stated Interest</i>	<i>Without Guarantee</i>	<i>Difference</i>	<i>Discounted at 5% Annually</i>	<i>Discounted Value</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):

<i>Year</i>	<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 E

The New Jersey Casino Reinvestment Development Authority

This appendix is nonauthoritative and is included for informational purposes only.

Applicability: *This appendix provides guidance applicable to nongovernmental gaming entities. Governmental gaming entities should refer to chapter 12, "Governmental Gaming Entities," and consider the implications of GASB 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 are typically accounted for as an expense. The multiple elements of the arrangement are generally accounted for at their fair value.

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/.

The primary accounting literature relating to investments in obligation deposits of the CRDA is FASB *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 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 would 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 would initially be 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 pertains to existing investments in obligation deposits, the Licensee will apply the

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.

accounting discussed in the appendix 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
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Appendix F

Currency Transaction Reporting in the Gaming Industry

This appendix is nonauthoritative and is included for informational purposes only.

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

It is the auditor's responsibility to obtain sufficient appropriate audit evidence regarding material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. Readers are encouraged to refer to AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* (AICPA, *Professional Standards*). For specific guidance relating to AU-C section 250, refer to chapter 13, "General Auditing Considerations."

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 need to 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 laundering

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.

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) 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 recordkeeping 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 will need to develop and implement a program to detect suspicious activity as 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 would 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 would 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 need to 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 are 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
- 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)

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

Appendix G

Rules of the Games

This appendix is nonauthoritative and is included for informational purposes only.

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

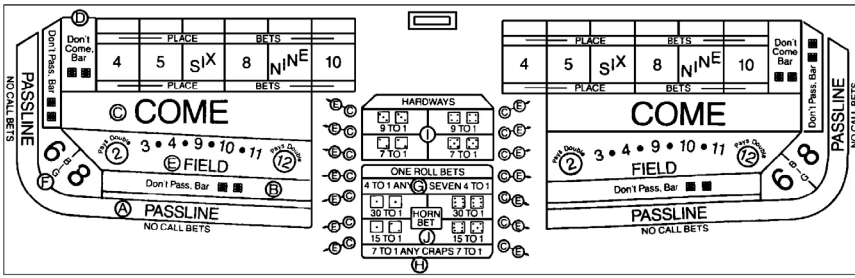
Craps is played on a large table and offers a variety of bets. Each bet is dependent upon the point value of the uppermost sides of two dice that come to rest after having been thrown by the *shooter*. Refer to the subsequent diagram of the craps table layout for placement of various bets.

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.



Craps Table Layout

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) or 6 to 5, depending on the house rules. 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.

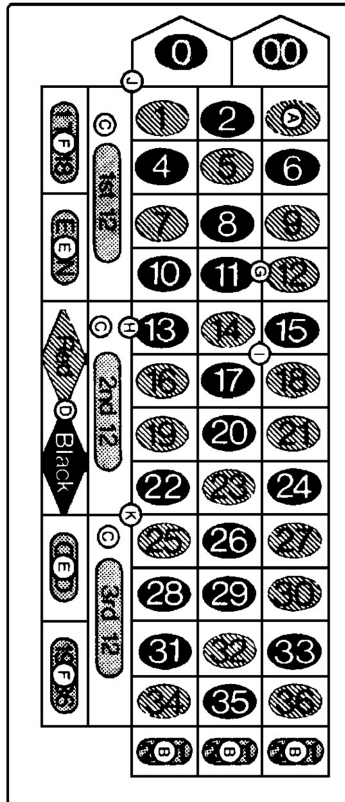
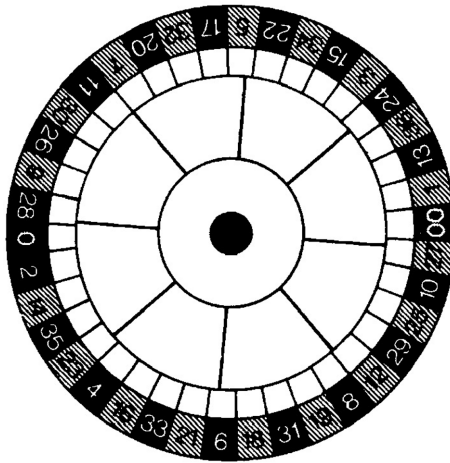
Insurance. If the dealer's up card is an ace, a player may elect to *take insurance* by placing, on the insurance line, a bet not greater than one-half of his original bet. The insurance bet is a wager that the dealer has blackjack. Insurance bets pay 2 to 1 if the dealer has blackjack, but they lose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



Roulette Table 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:

<i>A Bet On</i>	<i>Pays</i>
\$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:

<i>Having</i>	<i>Draws When Player's Third Card is</i>	<i>Does Not Draw When Player's Third Card is</i>
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

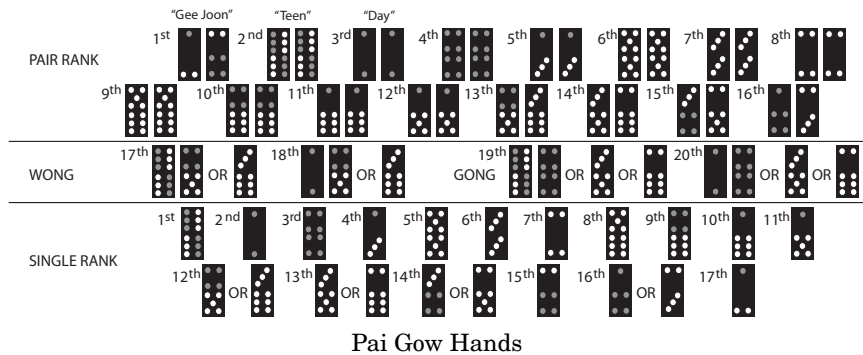
Pai Gow Tiles is an Asian game using dominoes, or tiles. The object of the game is to have both the high hand and the low hand be higher than the banker's hands (the banker is not necessarily the dealer). A banker is chosen by rolling a pair of dice and counting counterclockwise from the dealer. A player 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:

<u>Spread</u>	<u>Payout</u>
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

<i>Wager</i>	<i>Payout Odds</i>	<i>Wager</i>	<i>Payout Odds</i>
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 1 wins 60	5 1 wins 30	6 1 wins 17	7 1 wins 12	8 1 wins 8	9 1 wins 6	10 1 wins 6	11 1 wins 6	12 1 wins 6	13 1 wins 8	14 1 wins 12	15 1 wins 17	16 1 wins 30	17 1 wins 60
2 die 1 wins 5		1 and 2	1 and 3	1 and 4	1 and 5	1 and 6	2 and 3	2 and 4	2 and 5	2 and 6	3 and 4	3 and 5	3 and 6
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. If 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. If 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

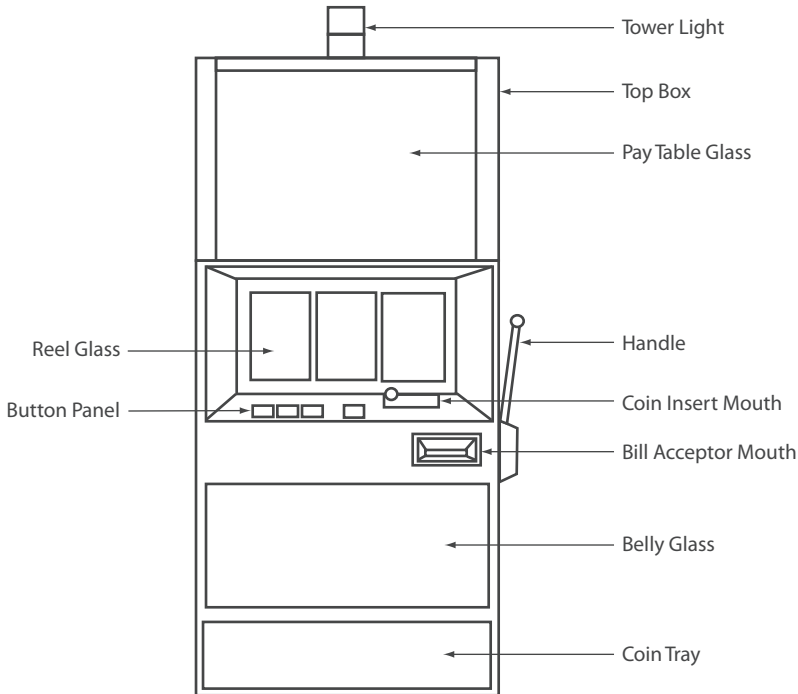
B I N G O				
14	25	34	52	68
1	24	38	51	69
4	26	Free	48	74
3	23	41	46	63
6	20	39	56	70

Bingo Card

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:



Slot Machine Diagram

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

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

for the electronic games are typically the same as those for their casino counterparts.

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

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.

pays out a fixed amount that is predetermined and is depicted on the pay table 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.

<u>Number of Spins</u>	<u>Expected Deviation</u>
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 multimillion 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 H

Overview of Statements on Quality Control Standards

This appendix is nonauthoritative and is included for informational purposes only.

This appendix is a partial reproduction of chapter 1 of the AICPA practice aid *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, available at www.aicpa.org/interestareas/frc/pages/enhancingauditqualitypracticeaid.aspx.

This appendix highlights certain aspects of the quality control standards issued by the AICPA. If appropriate, readers should also refer to the quality control standards issued by the PCAOB, available at www.pcaobus.org/standards/qc/pages/default.aspx.

1.01 The objectives of a system of quality control are to provide a CPA firm with reasonable assurance¹ that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that the firm or engagement partners issue reports that are appropriate in the circumstances. QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. That section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.

1.02 A system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those policies. The nature, extent, and formality of a firm's quality control policies and procedures will depend on various factors such as the firm's size; the number and operating characteristics of its offices; the degree of authority allowed to, and the knowledge and experience possessed by, firm personnel; and the nature and complexity of the firm's practice.

Communication of Quality Control Policies and Procedures

1.03 The firm should communicate its quality control policies and procedures to its personnel. Most firms will find it appropriate to communicate their policies and procedures in writing and distribute them, or make them available electronically, to all professional personnel. Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality

¹ The term *reasonable assurance*, which is defined as a high, but not absolute, level of assurance, is used because absolute assurance cannot be attained. Paragraph .53 of QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), states, "Any system of quality control has inherent limitations that can reduce its effectiveness."

- A requirement for each individual to be familiar with and to comply with these policies and procedures

Effective communication also includes procedures for personnel to communicate their views or concerns on quality control matters to the firm's management.

Elements of a System of Quality Control

1.04 A firm must establish and maintain a system of quality control. The firm's system of quality control should include policies and procedures that address each of the following elements of quality control identified in paragraph .17 of QC section 10:

- Leadership responsibilities for quality within the firm (the "tone at the top")
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

1.05 The elements of quality control are interrelated. For example, a firm continually assesses client relationships to comply with relevant ethical requirements, including independence, integrity, and objectivity, and policies and procedures related to the acceptance and continuance of client relationships and specific engagements. Similarly, the human resources element of quality control encompasses criteria related to professional development, hiring, advancement, and assignment of firm personnel to engagements, all of which affect policies and procedures related to engagement performance. In addition, policies and procedures related to the monitoring element of quality control enable a firm to evaluate whether its policies and procedures for each of the other five elements of quality control are suitably designed and effectively applied.

1.06 Policies and procedures established by the firm related to each element are designed to achieve reasonable assurance with respect to the purpose of that element. Deficiencies in policies and procedures for an element may result in not achieving reasonable assurance with respect to the purpose of that element; however, the system of quality control, as a whole, may still be effective in providing the firm with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements and that the firm or engagement partners issue reports that are appropriate in the circumstances.

1.07 If a firm merges, acquires, sells, or otherwise changes a portion of its practice, the surviving firm evaluates and, as necessary, revises, implements, and maintains firm-wide quality control policies and procedures that are appropriate for the changed circumstances.

Leadership Responsibilities for Quality Within the Firm (the "Tone at the Top")

1.08 The purpose of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that

quality is essential in performing engagements. The firm should establish and maintain the following policies and procedures to achieve this purpose:

- Require the firm's leadership (managing partner, board of managing partners, CEO, or equivalent) to assume ultimate responsibility for the firm's system of quality control.
- Provide the firm with reasonable assurance that personnel assigned operational responsibility for the firm's quality control system have sufficient and appropriate experience and ability to identify and understand quality control issues and develop appropriate policies and procedures, as well as the necessary authority to implement those policies and procedures.

1.09 Establishing and maintaining the following policies and procedures assists firms in recognizing that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs:

- Assign management responsibilities so that commercial considerations do not override the quality of the work performed.
- Design policies and procedures addressing performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel to demonstrate the firm's overarching commitment to the objectives of the system of quality control.
- Devote sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.

Relevant Ethical Requirements

1.10 The purpose of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- Require that personnel adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office, and any other applicable regulators.
- Establish procedures to communicate independence requirements to firm personnel and, where applicable, others subject to them.
- Establish procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.
- Require that the firm withdraw from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.

- Require written confirmation, at least annually, of compliance with the firm's policies and procedures on independence from all firm personnel required to be independent by relevant requirements.
- Establish procedures for confirming the independence of another firm or firm personnel in associated member firms who perform part of the engagement. This would apply to national firm personnel, foreign firm personnel, and foreign-associated firms.²
- Require the rotation of personnel for audit or attest engagements where regulatory or other authorities require such rotation after a specified period.

Acceptance and Continuance of Client Relationships and Specific Engagements

1.11 The purpose of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- is competent to perform the engagement and has the capabilities, including the time and resources, to do so;
- can comply with legal and relevant ethical requirements;
- has considered the client's integrity and does not have information that would lead it to conclude that the client lacks integrity; and
- has reached an understanding with the client regarding the services to be performed.

1.12 This assurance should be obtained before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- Evaluate factors that have a bearing on management's integrity and consider the risk associated with providing professional services in particular circumstances.³

² A *foreign-associated firm* is a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms.

³ Such considerations would include the risk of providing professional services to significant clients or to other clients for which the practitioner's objectivity or the appearance of independence

(continued)

- Evaluate whether the engagement can be completed with professional competence; undertake only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluate, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.
- Obtain an understanding, preferably in writing, with the client regarding the services to be performed.
- Establish procedures on continuing an engagement and the client relationship, including procedures for dealing with information that would have caused the firm to decline an engagement if the information had been available earlier.
- Require documentation of how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.

Human Resources

1.13 The purpose of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (a) to perform its engagements in accordance with professional standards and regulatory and legal requirements, and (b) to enable the firm to issue reports that are appropriate in the circumstances. Establishing and maintaining policies such as the following assist the firm in obtaining this assurance:

- Recruit and hire personnel of integrity who possess the characteristics that enable them to perform competently.
- Determine capabilities and competencies required for an engagement, especially for the engagement partner, based on the characteristics of the particular client, industry, and kind of service being performed. Specific competencies necessary for an engagement partner are discussed in paragraph .A27 of QC section 10.
- Determine the capabilities and competencies possessed by personnel.
- Assign the responsibility for each engagement to an engagement partner.
- Assign personnel based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.
- Have personnel participate in general and industry-specific continuing professional education and professional development activities that enable them to accomplish assigned responsibilities

(footnote continued)

may be impaired. In broad terms, the significance of a client to a member or a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. Examples of factors to consider in determining the significance of a client to an engagement partner, office, or practice unit include (a) the amount of time the partner, office, or practice unit devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of his or her service to the client, (c) the manner in which the partner, office, or practice unit is compensated, or (d) the effect that losing the client would have on the partner, office, or practice unit.

and satisfy applicable continuing professional education requirements of the AICPA, state boards of accountancy, and other regulators.

- Select for advancement only those individuals who have the qualifications necessary to fulfill the responsibilities they will be called on to assume.

Engagement Performance

1.14 The purpose of the engagement performance element of quality control is to provide the firm with reasonable assurance (*a*) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements, and (*b*) that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed.

1.15 Establishing and maintaining policies such as the following assist the firm in obtaining the assurance required relating to the engagement performance element of quality control:

- Plan all engagements to meet professional, regulatory, and the firm's requirements.
- Perform work and issue reports and other communications that meet professional, regulatory, and the firm's requirements.
- Require that work performed by other team members be reviewed by qualified engagement team members, which may include the engagement partner, on a timely basis.
- Require the engagement team to complete the assembly of final engagement files on a timely basis.
- Establish procedures to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.
- Require the retention of engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.
- Require that
 - consultation take place when appropriate (for example, when dealing with complex, unusual, unfamiliar, difficult, or contentious issues);
 - sufficient and appropriate resources be available to enable appropriate consultation to take place;
 - all the relevant facts known to the engagement team be provided to those consulted;

- the nature, scope, and conclusions of such consultations be documented; and
- the conclusions resulting from such consultations be implemented.
- Require that
 - differences of opinion be dealt with and resolved;
 - conclusions reached are documented and implemented; and
 - the report not be released until the matter is resolved.
- Require that
 - all engagements be evaluated against the criteria for determining whether an engagement quality control review should be performed;
 - an engagement quality control review be performed for all engagements that meet the criteria; and
 - the review be completed before the report is released.
- Establish procedures addressing the nature, timing, extent, and documentation of the engagement quality control review.
- Establish criteria for the eligibility of engagement quality control reviewers.

Monitoring

1.16 The purpose of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports issued by the firm are appropriate in the circumstances

1.17 Establishing and maintaining policies such as the following assist the firm in obtaining the assurance required relating to the monitoring element of quality control:

- Assign responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility.

- Assign performance of the monitoring process to competent individuals.
- Require the performance of monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures. Monitoring procedures consist of the following:
 - Review of selected administrative and personnel records pertaining to the quality control elements.
 - Review of engagement documentation, reports, and clients' financial statements.
 - Summarization of the findings from the monitoring procedures, at least annually, and consideration of the systemic causes of findings that indicate that improvements are needed.
 - Determination of any corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures.
 - Communication of the identified findings to appropriate firm management personnel.
 - Consideration of findings by appropriate firm management personnel who should also determine that any actions necessary, including necessary modifications to the quality control system, are taken on a timely basis.
 - Assessment of
 - the appropriateness of the firm's guidance materials and any practice aids;
 - new developments in professional standards and regulatory and legal requirements and how they are reflected in the firm's policies and procedures where appropriate;
 - compliance with policies and procedures on independence;
 - the effectiveness of continuing professional development, including training;
 - decisions related to acceptance and continuance of client relationships and specific engagements; and
 - firm personnel's understanding of the firm's quality control policies and procedures and implementation thereof.
- Communicate at least annually, to relevant engagement partners and other appropriate personnel, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.

- Communicate the results of the monitoring of its quality control system process to relevant firm personnel at least annually.
- Establish procedures designed to provide the firm with reasonable assurance that it deals appropriately with the following:
 - Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements.
 - Allegations of noncompliance with the firm's system of quality control.
 - Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations.

This includes establishing clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisal and documenting complaints and allegations and the responses to them.

- Require appropriate documentation to provide evidence of the operation of each element of its system of quality control. The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following, for example:
 - The size of the firm and the number of offices.
 - The nature and complexity of the firm's practice and organization.
- Require retention of documentation providing evidence of the operation of the system of quality control for a period of time sufficient to permit those performing monitoring procedures and peer review to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

1.18 Some of the monitoring procedures discussed in the previous list may be accomplished through the performance of the following:

- Engagement quality control review
- Review of engagement documentation, reports, and clients' financial statements for selected engagements after the report release date
- Inspection⁴ procedures

⁴ *Inspection* is a retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Although monitoring procedures are meant to be ongoing, they may include inspection procedures performed at a fixed point in time. Monitoring is a broad concept; inspection is one specific type of monitoring procedure.

Documentation of Quality Control Policies and Procedures

1.19 The firm should document each element of its system of quality control. The extent of the documentation will depend on the size, structure, and nature of the firm's practice. Documentation may be as simple as a checklist of the firm's policies and procedures or as extensive as practice manuals.

Appendix I

The New Leases Standard: FASB ASU No. 2016-02

This appendix is nonauthoritative and is included for informational purposes only.

Overview

Issuance and Objective

On February 25, 2016, FASB issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*. The objective of the ASU is to increase transparency and comparability in financial reporting by requiring balance sheet recognition of leases and note disclosure of certain information about lease arrangements. This ASU codifies the new FASB ASC topic 842, *Leases*, and makes conforming amendments to other FASB ASC topics.

The new FASB ASC topic on leases consists of these subtopics:

- a. Overall
- b. Lessee
- c. Lessor
- d. Sale and leaseback transactions
- e. Leveraged lease arrangements

Applicability and Effective Date

ASU No. 2016-02 is applicable to any entity that enters into a lease and is effective as follows:

	<i>Fiscal Years Beginning After</i>	<i>Interim Periods Within Fiscal Years Beginning After</i>
Public business entities, certain not-for-profit entities with conduit financing arrangements, and employee benefit plans	December 15, 2018	December 15, 2018
All other entities	December 15, 2019	December 15, 2020

FASB ASC 842 applies to all leases and subleases of property, plant, and equipment; it specifically does not apply to the following nondepreciable assets accounted for under other FASB ASC topics:

- a. Leases of intangible assets
- b. Leases to explore for or use nonregenerative resources such as minerals, oil, and natural gas
- c. Leases of biological assets, such as timber

- d. Leases of inventory
- e. Leases of assets under construction

Main Provisions

Overall

Identifying a Lease

Key changes in the guidance are illustrated by comparing the definition of a lease in FASB ASC 840 (extant GAAP) and FASB ASC 842.

<i>FASB ASC 840</i>	<i>FASB ASC 842</i>
An agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time.	A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

The identification of a lease under FASB ASC 842 should be based on the presence of key elements in the definition.

Separating Components of a Lease Contract

Under FASB ASC 842, a contract that contains a lease should be separated into lease and nonlease components. Separation should be based on the right to use; each underlying asset should be considered to be separate from other lease components when both of the following criteria are met:

- a. The lessee can benefit from the right-of-use of the asset (either alone or with other readily available resources)
- b. The right-of-use is neither highly dependent on or highly interrelated with other underlying assets in the contract

The consideration in the contract should be allocated to the separate lease and nonlease components in accordance with provisions of FASB ASC 842.

Lessees can make an accounting policy election to treat both lease and nonlease elements as a single lease component.

Lease Classification

When a lease meets any of the following specified criteria at commencement, the lease should be classified by the lessee and lessor as a finance lease and a sales-type lease, respectively. These criteria can be summarized as follows:

- a. Transfers ownership to lessee
- b. Purchase option reasonably certain to be exercised
- c. Lease term for major portion of asset's remaining economic life
- d. Present value of lease payments and residual value exceeds substantially all of the fair value of the underlying asset
- e. Specialized nature of underlying asset results in no expectation of alternative use after the lease term

If none of the above criteria are met, the lease should be classified as follows:

Lessee—classify as an operating lease

Lessor—classify as an operating lease unless (1) the present value of the lease payments and any residual value guarantee that equals or exceeds substantially all of the fair value of the underlying asset and (2) it is probable that the lessor will collect the lease payments plus any residual value guarantee. If both of these summarized criteria from FASB ASC 842-10-25-3 are met, the lessor should classify the lease as a direct financing lease.

Lease Term and Measurement

The lease term is the noncancellable period of the lease together with all of the following:

- a. Period covered by the option for the lessee to extend the lease if the option is reasonably certain to be exercised
- b. Period covered by option for lessee to terminate the lease if reasonably certain not to be exercised
- c. Period covered by option for lessor to extend or not terminate the lease if option is controlled by lessor.

Lease Payments

Lease payments relating to use of the underlying asset during the lease term include the following at the commencement date:

- a. Fixed payments less incentives payable to lessee
- b. Variable lease payments based on an index or other rate
- c. Exercise price of an option to purchase the underlying asset if it is reasonably certain to be exercised
- d. Payments for penalties for terminating a lease if the lease term reflects exercise of lessee option
- e. Fees paid by the lessee to the owners of a special purpose entity for structuring the lease
- f. For lessee only, amounts probable of being owed under residual value guarantees

Lease payments specifically exclude the following:

- a. Certain other variable lease payments
- b. Any guarantee by the lessee of the lessor's debt
- c. Certain amounts allocated to nonlease components

Reassessment of the lease term and purchase options, and subsequent remeasurement by either the lessee or lessor are limited to certain specified circumstances.

Lessee

Recognition and Measurement

Commencement Date

At the commencement date of the lease, a lessee should recognize a right-of-use asset and a lease liability; for short term leases, an alternative accounting policy election is available.

The lease liability should be measured at the present value of the unpaid lease payments. The right-of-use asset should consist of the following: the amount of the initial lease liability; any lease payments made to lessor at or before the commencement date minus any incentives received; and initial direct costs.

A short term lease is defined by the FASB ASC master glossary as a lease that, at the commencement date has a lease term of 12 months or less and does not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise. The accounting policy election for short term leases should be made by class of underlying asset. The election provides for recognition of the lease payments in profit or loss on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred.

After the Commencement Date

After the commencement date, the lessee should recognize in profit or loss (unless costs are included in the carrying amount of another asset) the following:

- Finance leases:
 - a. Amortization of the right-of-use asset and interest on the lease liability
 - b. Variable lease payments not included in the lease liability in the period obligation incurred
 - c. Any impairment
- Operating leases:
 - a. A single lease cost calculated such that the remaining cost is allocated on a straight line basis over the remaining lease term (unless another allocation is more representative of the benefit from use of the asset)
 - b. Variable lease payments not included in the lease liability in the period in which the obligation is incurred
 - c. Any impairment

Subsequent Measurement

FASB ASC 842-20-35 provides guidance for subsequent measurement.

Presentation and Disclosure

Key presentation matters include the following:

- Statement of financial position.
 - Separate presentation of right-of-use assets and lease liabilities from finance leases and operating leases.
- Statement of comprehensive income.
 - Finance leases—interest expense on the lease liability and amortization of right-of-use asset in a manner consistent with how the entity presents other interest expense and depreciation or amortization of similar assets.
 - Operating leases—expense to be included in the lessee's income from continuing operations.

- Statement of cash flows.
 - Presentation within financing activities—the repayment of the principal portion of the lease liability arising from finance leases.
 - Presentation within operating activities—payments arising from operating leases; interest payments on the lease liability; variable lease payments and short term lease payments not included in lease liability.

Disclosure requirements include qualitative and quantitative information for leases, significant judgements, and amounts recognized in the financial statements, including certain specified information and amounts.

Lessor

Recognition and Measurement

FASB ASC 842 provides recognition guidance for sales-type leases, direct financing leases, and operating leases. The following table summarizes the guidance:

<i>Sales-Type Leases</i>	
At the Commencement Date	After the Commencement Date
Lessor should derecognize the underlying asset and recognize the following: <ul style="list-style-type: none"> a. Net investment in the lease (lease receivable and unguaranteed residual asset) b. Selling profit or loss arising from the lease c. Initial direct costs as an expense 	Lessor should recognize all of the following: <ul style="list-style-type: none"> a. Interest income on the net investment in the lease b. Certain variable lease payments c. Impairment
<i>Direct Financing Leases</i>	
At the Commencement Date	After the Commencement Date
Lessor should derecognize the underlying asset and recognize the following: <ul style="list-style-type: none"> a. Net investment in the lease (lease receivable and unguaranteed residual asset reduced by selling profit) b. Selling loss arising from the lease, if applicable 	Lessor should recognize all of the following: <ul style="list-style-type: none"> a. Interest income on the net investment in the lease b. Certain variable lease payments c. Impairment

(continued)

<i>Operating Leases</i>	
At the Commencement Date	After the Commencement Date
Lessor should defer initial direct costs.	Lessor should recognize all of the following: <ol style="list-style-type: none"> a. The lease payments as income in profit or loss over the lease term on a straight line basis (unless another method in more representative of the benefit received) b. Certain variable lease payments as income in profit or loss c. Initial direct costs as an expense over the lease term on the same basis as lease income

FASB ASC 842-30-35 provides guidance for subsequent measurement.

Presentation and Disclosure

Key presentation matters include the following:

For sales-type and direct financing leases:

- Statement of financial position
 - Separate presentation of lease assets (that is, aggregate of lessor's net investment in sales-type leases and direct financing leases) from other assets.
 - Classified as current or noncurrent based on same considerations as other assets.
- Statement of comprehensive income
 - Presentation of income from leases in the statement of comprehensive income or disclosure of income from leases in the notes with a reference to the corresponding line in the statement of comprehensive income.
 - Presentation of profit or loss recognized at commencement date in a manner appropriate to lessor's business model.
- Statement of cash flows
 - Presentation within operating activities—cash receipts from leases.

For operating leases:

- Statement of financial position

- Presentation of an underlying asset subject to an operating leases in accordance with other FASB ASC topics.
- Statement of cash flows
 - Presentation within operating activities—cash receipts from leases.

Disclosure requirements include qualitative and quantitative information for leases, significant judgements, and amounts recognized in the financial statements, including certain specified information and amounts.

Sale and Leaseback Transactions

FASB ASC 842 provides guidance for both the transfer contract and the lease in a sale and leaseback transaction (a transaction in which a seller-lessee transfers an asset to a buyer-lessor and leases that asset back). Determination of whether the transfer is a sale should be based on provisions of FASB ASC 606, *Revenue from Contracts with Customers*. FASB ASC 842-40-25 provides measurement guidance for a transfer that is either determined to be a sale or determined not to be a sale.

FASB ASC 842-40 provides guidance for subsequent measurement, financial statement presentation, and disclosures.

Leveraged Lease Arrangements

The legacy accounting model for leveraged leases continues to apply to those leveraged leases that commenced before the effective date of FASB ASC 842. There is no separate accounting model for leveraged leases that commence after the effective date of FASB ASC 842.

Appendix J

Schedule of Changes Made to the Text from the Previous Edition

As of September 1, 2017

This schedule of changes identifies areas in the text and footnotes of this guide that have been changed from the previous edition. Entries in the table of this appendix reflect current numbering, lettering (including that in appendix names), and character designations that resulted from the renumbering or re-ordering that occurred in the updating of this guide.

<i>Reference</i>	<i>Change</i>
Preface	Updated.
General	Guide content included in shaded areas and "Guidance Update" boxes within the chapters have been updated to appropriately reflect guidance not yet effective as of the date of the guide. See the Preface of this guide for more explanation of this "dual guidance" treatment.
General	Editorial changes, including rephrasing, may have been made in this guide to improve readability where necessary.
General	PCAOB standards content has been removed from the guide.
Paragraphs 1.05, 1.17, and 1.19	Revised for changes in the gaming industry, not related to an issuance of new authoritative guidance.
Paragraph 1.22	Revised due to the passage of time.
Paragraph 1.39	Revised for changes in the gaming industry, not related to an issuance of new authoritative guidance.
Paragraph 2.02	Revised to reflect the issuance of GASB No. 76, <i>The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments</i> .
Footnote 3 in paragraph 2.03	Added to provide information related to the use of inappropriate standards in reporting.

(continued)

<u>Reference</u>	<u>Change</u>
Paragraph 3.33	Revised to provide further understanding of characteristics relating to incentives, not related to an issuance of new authoritative guidance.
Footnote 1 in paragraph 11.01	Added to reflect the issuance of FASB Accounting Standards Update No. 2014-18, <i>Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination (a consensus of the Private Company Council)</i> , accounting alternative elective.
Heading before paragraph 12.02	Revised to provide further understanding of the generally accepted accounting principles Hierarchy for Governmental Entities, not related to an issuance of new guidance.
Heading before paragraph 12.02, paragraph 12.02, footnotes 1–2 to paragraph 12.02	Added to reflect the issuance of GASB No. 76.
Former paragraph 12.03	Deleted to reflect the issuance of GASB No. 76.
Paragraphs 12.03–.04	Added to reflect the issuance of GASB No. 76.
Paragraph 12.05	Revised to reflect the issuance of GASB Nos. 72, <i>Fair Value Measurement and Application</i> , and 76.
Paragraph 13.144	Revised to reflect the issuance of Statement on Auditing Standards (SAS) No. 128, <i>Using the Work of Internal Auditors</i> (AICPA, <i>Professional Studies</i> , AU-C sec. 610).
Paragraph 13.166	Revised to reflect the issuance of SAS No. 130, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i> (AICPA, <i>Professional Studies</i> , AU-C sec. 940).
Heading before paragraph 13.167	Revised to reflect the issuance of SAS No. 132, <i>The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i> (AICPA, <i>Professional Studies</i> , AU-C sec. 570);

<u>Reference</u>	<u>Change</u>
Footnote 17 to paragraph 13.167	Added to reflect the issuance of FASB <i>Accounting Standards Codification</i> 205-40, <i>Presentation of Financial Statements—Going Concern</i> , and GASB No. 56, <i>Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards</i> .
Paragraph 13.167	Revised to reflect the issuance of SAS No. 132.
Paragraph 13.185	Revised to provide further understanding of the auditor's responsibility relating to RSI and supplementary information, not related to an issuance of new authoritative guidance.
Appendix A	Revised for passage of time.
Former Appendix B	Deleted.
Appendix B	Updated.
Appendix C	Updated.
Appendix H	Added.
Appendix I	Added.

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 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.
- deskperson.** An employee who authorizes payment on winning tickets and verifies payouts in keno.
- discard tray.** A tray, box, or specific area where cards used in a 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 lottery 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.

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.
- ring game.** An online card table where players can enter and depart as they please while playing for real money. The online version of a brick and mortar poker room.
- 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.
- sit and go (single table tournament).** An online tournament where players are at a virtual single table, and payouts are made based upon placing at that single table. All players must enter and start play at the same time and have the same ending point for the event.
- 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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