

University of Mississippi

eGrove

Industry Guides (AAGs), Risk Alerts, and
Checklists

American Institute of Certified Public
Accountants (AICPA) Historical Collection

9-1-2018

Gaming, September 1, 2018: Audit and Accounting Guide

American Institute of Certified Public Accountants (AICPA)

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_indev



Part of the [Accounting Commons](#)



Audit and Accounting Guide

Gaming

September 1, 2018



Gaming | September 1, 2018



9 781948 306096

AAGGAM18P

aicpa.org | AICPAStore.com





Audit and Accounting Guide

Gaming

September 1, 2018



23574-349

Copyright © 2018 by
American Institute of Certified Public Accountants. All rights reserved.

For information about the procedure for requesting permission to make copies of
any part of this work, please email copyright@aicpa.org with your request.
Otherwise, requests should be written and mailed to Permissions Department,
220 Leigh Farm Road, Durham, NC 27707-8110.

1 2 3 4 5 6 7 8 9 0 AAP 1 9 8

ISBN 978-1-94830-609-6

Preface



(Updated as of September 1, 2018)

About AICPA Guides

This AICPA Guide has been developed by the AICPA Gaming Guide Task Force to assist practitioners in performing and reporting on their audit engagements and to assist management in the preparation of their financial statements in conformity with U.S. generally accepted accounting principles (GAAP).

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*.¹ 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

¹ All AU-C sections can be found in AICPA *Professional Standards*.

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*.² 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 interpretive publication, the practitioner should document how the requirements of the SSAE were complied with in the circumstances 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 and Accounting and Review Services Committee are the designated senior committees of the AICPA authorized to speak for the AICPA on all matters related to attestation in their respective areas of responsibility. 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.

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 approved 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

² All AT-C sections can be found in AICPA *Professional Standards*.

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 the FASB *Accounting Standards Codification*[®] (ASC) and GAAP for governmental entities.
- 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 SEC.

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," (ET sec. 1.320.001 and 2.320.001).³

AICPA Guides may include certain content presented as "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.

Recognition

2018 Guide Edition
AICPA Senior Committees

³ All ET sections can be found in AICPA *Professional Standards*.

Auditing Standards Board

Michael J. Santay, *Chair*

Dora Burzenski, *Member*

Financial Reporting Executive Committee

Daniel Noll

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, Patrick Pruitt, Tasha Repp, and Michael Winterscheidt.

The AICPA gratefully appreciates the invaluable assistance Renee Rampulla provided in updating and maintaining the guidance in the 2018 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, 2018, 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, 2018, is incorporated directly in the text of this guide. Relevant guidance issued but not yet effective as of September 1, 2018, but becoming effective on or before December 31, 2018, 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, 2018, 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. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*
- GASB statements, interpretations, and technical bulletins issued through September 1, 2018

- GASB Implementation Guidance Update No. 2018-1, *Implementation Guidance Update—2018*, issued May 2018
- SAS No. 133, *Statement on Auditing Standards, Auditor Involvement With Exempt Offering Documents* (AU-C sec. 945)
- Statement of Position 17-1, *Performing Agreed-Upon Procedures Related to Rated Exchange Act Asset-Backed Securities Third-Party Due Diligence Services as Defined by SEC Release No. 34-72936* (AUD sec. 60)⁴
- SSAE No. 18, *Attestation Standards: Clarification and Recodification*

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 K, "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*, © 2018, 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, 2018, 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).

⁴ All AUD sections can be found in *AICPA Professional Standards*.

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 Quality Control Standards

QC section 10, *A Firm's System of Quality Control*,⁵ 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" (ET sec. 1.310.001) 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

⁵ All QC sections can be found in *AICPA Professional Standards*.

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*
- AT-C section 105
- AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*⁶

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 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

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.

⁶ All AR-C sections can be found in *AICPA Professional Standards*.

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

FASB ASC 606, *Revenue from Contracts With Customers*

FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and related guidance in subsequently issued ASUs, is effective for annual reporting periods of public business entities, certain not-for-profits and certain employee benefit plans, beginning after December 15, 2017, including interim periods within that reporting period. Earlier application would be permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

All other nongovernmental entities, would apply the guidance in ASU No. 2014-09 to annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Application would be 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.

The AICPA has formed sixteen industry task forces to assist in developing a new accounting guide on revenue recognition that will provide helpful hints and illustrative examples for how to apply the new standard. Information regarding these task forces can be found at www.aicpa.org/revenuerecognition. Finalized revenue recognition implementation issues for a given industry are published in a quarterly edition of the AICPA Audit and Accounting Guide *Revenue Recognition*. The revenue recognition implementation issues related to the gaming industry are found in chapter 6, "Gaming Entities," of that guide.

In this guide, revenue recognition implementation issues, as found in chapter 6, "Gaming Entities," of the AICPA *Revenue Recognition* guide, are found in appendix J, "Revenue Recognition Implementation Issues." These implementation issues affect content in a number of places throughout the guide, including content in chapters, appendixes, and the glossary. Guide content will be updated in a future edition of the guide.

Government Auditing Standards, 2018 Revision

On July 17, 2018 the Government Accountability Office released the 2018 Revision of *Government Auditing Standards* (GAGAS or the Yellow Book). The standards are available at <https://www.gao.gov/yellowbook/overview>. *Government Auditing Standards*, 2018 Revision, is effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020, and for performance audits beginning on or after July 1, 2019. Early implementation is not permitted. Upon their effective date, *Government Auditing Standards*, 2018 Revision, will supersede *Government Auditing Standards*, 2011 Revision.

TABLE OF CONTENTS

Chapter		Paragraph
1	Industry Overview	.01-46
	Gaming in the United States .....	.01-24
	Casino Gaming .....	.01-09
	Native American Gaming .....	.10-11
	Lotteries .....	.12-16
	Other Gaming .....	.17-24
	Regulation and Oversight .....	.25-37
	Brief Descriptions of the Games .....	.38-46
	Table Games .....	.39
	Card Games .....	.40
	Slot Machines .....	.41-42
	Keno .....	.43
	Bingo .....	.44
	Race and Sports Betting .....	.45
	Online Real Money Gaming .....	.46
2	Guide Scope and Applicability	.01-04
3	Overview of Gaming and Gaming Related Revenue	.01-42
	Introduction .....	.01-13
	Overview of Transactions in the Casino and the Casino Cage .....	.14-42
	Overview of Table Game Transactions .....	.14-32
	Overview of Incentive Programs in the Gaming Industry ...	.33-42
4	Jackpot Liabilities	.01-10
	Background .....	.01
	Summary of Selected Accounting Literature .....	.02
	Types of Jackpots for Purposes of Accounting for Jackpot Liabilities .....	.03-07
	Accounting for Jackpots .....	.08-10
5	Participation and Similar Arrangements	.01-09
	Background .....	.01-03
	Summary of Selected Accounting Literature .....	.04
	Analysis of Lease Criteria for Various Pricing Arrangements .....	.05
	Conclusions and Income Statement Presentation .....	.06-09
6	Loyalty and Incentive Programs	.01-29
	Summary of Selected Accounting Literature .....	.01
	General Description of, and Accounting for, Loyalty and Incentive Programs .....	.02-.12

Chapter		Paragraph
6	Loyalty and Incentive Programs—continued	
	Discretionary Incentive Programs .....	.03-08
	Nondiscretionary Incentive Programs .....	.09-12
	Specific Accounting for Various Discretionary Incentives .....	.13-16
	Free Play Offered Other Than Through Loyalty Programs ...	.13
	Cash or Cash Equivalents Offered Other Than Through Loyalty Programs .....	.14-15
	Complimentaries Offered Other Than Through Loyalty Programs .....	.16
	Specific Accounting for Various Nondiscretionary Incentives .....	.17-28
	Free Play Offered Through Nondiscretionary Loyalty Programs .....	.17-19
	Cash or Cash Equivalents Offered Through Nondiscretionary Loyalty Programs .....	.20-21
	Complimentaries Offered Through Nondiscretionary Loyalty Programs .....	.22-26
	Nondiscretionary Loyalty Programs in Which Customers Have the Option of Choosing Multiple Types of Incentives .....	.27
	Incentive Programs That Provide Customers With Designated Status Without Entitling Customers to Any Economic Benefits .....	.28
	Financial Statement Disclosures .....	.29
7	Gaming License, Project Development, and Preopening and Start-Up Costs	.01-15
	Background .....	.01-02
	Summary of Selected Accounting Literature .....	.03
	Costs to Obtain a Gaming License .....	.04-11
	Project Development Costs .....	.12-13
	Preopening and Start-Up Costs .....	.14-15
8	Managing Properties for Third Parties	.01-21
	Background .....	.01-04
	Summary of Selected Accounting Literature .....	.05-06
	Accounting by the Gaming Entity Managing the Third Party Owned Property .....	.07-15
	Gaming Entity's Costs Prior to Obtaining the Management Agreement .....	.07-11
	Gaming Entity's Costs Related to an Existing Management Agreement .....	.12-14
	Financial Statement Classification of Amounts Paid on Behalf of the Managed Property .....	.15
	Accounting by the Managed Property .....	.16-19
	Disclosures .....	.20-21

Table of Contents

XV

Chapter		Paragraph
9	Guarantees	.01-.29
	Introduction .....	.01
	Summary of Selected Accounting Literature .....	.02-.27
	Initial Recognition and Measurement of the Guarantee .....	.04-.13
	Income Statement Effect at Initial Recognition .....	.14
	Classification of the Contract or Customer Acquisition Cost .....	.15
	Subsequent Measurement of the Liability .....	.16-.22
	Subsequent Measurement of the Asset .....	.23-.27
	Financial Statement Disclosures .....	.28-.29
	Applicability of FASB ASC 810, <i>Consolidation</i> .....	.29
10	Long-Lived Assets	.01-.21
	Introduction .....	.01
	Summary of Selected Accounting Literature .....	.02-.20
	Long-Lived Assets to Be Held and Used .....	.03
	Triggering Events .....	.04-.06
	Grouping Long-Lived Assets to Be Held and Used and Related Issues .....	.07-.12
	Estimates of Future Cash Flows Used to Test a Long-Lived Asset for Recoverability .....	.13-.20
	Asset Retirement Obligations .....	.21
11	Other Accounting Topics	.01-.28
	Intangible Assets Acquired in a Business Combination .....	.01-.04
	Jackpot Insurance .....	.05-.13
	Background .....	.05-.07
	Characteristics of Jackpot Insurance Policies .....	.08-.10
	Accounting for Jackpot Insurance .....	.11-.13
	Gaming Chips and Tokens Liabilities .....	.14-.18
	Racetrack Fees .....	.19-.23
	Background .....	.19-.21
	Accounting for Racetrack Fees .....	.22-.23
	Segment Reporting .....	.24-.26
	Uniforms and Other Long-Lived Assets .....	.27
	Deferred Income Taxes for Casinos .....	.28
12	Governmental Gaming Entities	.01-.22
	Background .....	.01
	GAAP Hierarchy for Governmental Gaming Entities .....	.02-.04
	Summary of Selected Accounting Literature .....	.05
	Basic Financial Statements and Required Supplementary Information .....	.06-.12

Chapter		Paragraph
12	Governmental Gaming Entities—continued	
	Resource Flows Between Governmental Gaming Entities and Sponsoring Governments .....	.13-.15
	Allocation of Assets and Liabilities Within the Financial Reporting Entity .....	.16
	Impairment of Capital Assets .....	.17-.22
	Segment Reporting .....	.22
13	General Auditing Considerations	.01-.193
	Introduction .....	.01-.04
	Terms of Engagement .....	.05-.10
	Opening Balances—Initial Audit Engagements, Including Reaudit Engagements .....	.11
	An Audit of Financial Statements .....	.12-.24
	Planning the Audit .....	.14-.16
	Audit Risk .....	.17-.22
	Use of Assertions in Obtaining Audit Evidence in the Assessment of Risks of Material Misstatement .....	.23-.24
	Materiality .....	.25-.31
	Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement .....	.32-.40
	Discussion Among the Audit Team .....	.39
	Industry Risk Factors .....	.40
	Related Parties .....	.41-.44
	Responsibilities of the Auditor .....	.43-.44
	Risk Assessment Procedures .....	.45-.47
	Designing and Performing Further Audit Procedures .....	.48-.54
	Identification of Significant Risks .....	.52
	Analytical Procedures Used in Risk Assessment .....	.53-.54
	Understanding of Internal Control .....	.55-.64
	IT Considerations .....	.65-.72
	Consideration of Fraud in a Financial Statement Audit .....	.73-.111
	Introduction .....	.73-.75
	Professional Skepticism .....	.76-.77
	Discussion Among the Engagement Team .....	.78-.81
	Incentives or Pressures .....	.82-.84
	Opportunities .....	.85-.86
	Attitudes and Rationalizations .....	.87
	Misappropriation of Assets .....	.88-.91
	Risk Assessment Procedures and Related Activities .....	.92-.95
	Identification and Assessment of the Risks of Material Misstatement Due to Fraud .....	.96-.99
	Responses to the Assessed Risks of Material Misstatement Due to Fraud .....	.100-.102

Chapter		Paragraph
13	General Auditing Considerations—continued	
	Evaluation of Audit Evidence .....	.103-.107
	Auditor Unable to Continue the Engagement .....	.108
	Communications to Management and With Those Charged With Governance .....	.109-.110
	Documentation .....	.111
	Consideration of Laws and Regulations .....	.112-.117
	Responsibility for Compliance With Laws and Regulations .....	.113-.117
	Audit Performance and Execution .....	.118-.126
	Designing and Performing Further Audit Procedures .....	.118-.126
	Timing of Audit Procedures .....	.127-.130
	Analytical Procedures Used in Audit Performance .....	.131-.135
	Audit Documentation .....	.136-.143
	Timely Preparation of Audit Documentation .....	.139-.142
	Assembly and Retention of the Final Audit File .....	.143
	Auditor’s Consideration of Using the Work of Internal Auditors .....	.144
	Using the Work of Other Specialists .....	.145-.149
	Evaluation of Misstatements Identified During the Audit .....	.150-.151
	Written Representations .....	.152-.160
	Written Representations as Audit Evidence .....	.153-.160
	Communication With Those Charged With Governance .....	.161-.166
	Auditor’s Consideration of Going Concern .....	.167-.182
	Risk Assessment Procedures and Related Activities .....	.171-.172
	Additional Audit Procedures .....	.173-.174
	Consideration of Conditions and Events .....	.175-.176
	Auditor Conclusions .....	.177-.180
	Communicate With Those Charged With Governance .....	.181
	Documentation .....	.182
	Group Audit Engagements .....	.183-.188
	Definition of a Component .....	.186-.187
	Group Audit Technical Practice Aid .....	.188
	Other Information, Supplementary Information, and Required Supplementary Information .....	.189-.193
14	Special Auditing Considerations	.01-.52
	Cash Balances and Revenue Cutoff .....	.02-.06
	Components of Cage Accountability .....	.03-.04
	Cage Procedures .....	.05-.06
	Tests of Accountability .....	.07-.13
	Cutoff Procedures .....	.14-.22
	Table Games .....	.16-.17

Chapter		Paragraph
14	Special Auditing Considerations—continued	
	Slot Machines .....	.18-.19
	Other Games .....	.20-.22
	Online Gaming .....	.23
	Drop and Count Procedures .....	.24-.27
	Receivables .....	.28-.31
	Background .....	.28-.31
	External Confirmation of Gaming Receivables .....	.32-.45
	Mail Circularization .....	.42
	Oral Responses .....	.43-.44
	Alternative Procedures When No Reply Is Received .....	.45
	Branch Offices .....	.46
	Allowance for Doubtful Accounts .....	.47-.52
	Special Considerations for New Gaming Operations .....	.49
	Unannounced Audit Procedures .....	.50-.52
15	Internal Control	.01-.53
	Introduction .....	.01-.08
	Gaming Internal Control Considerations .....	.09
	Granting and Control of Credit .....	.10-.15
	Approval of Credit Lines and Maintenance of Credit Files .....	.10
	Issuance of Credit .....	.11-.12
	Recording of Credit Transactions .....	.13
	Custody of Markers .....	.14-.15
	Bingo .....	.16-.19
	Cage .....	.20-.22
	Card Games .....	.23-.25
	Gaming Tournaments .....	.26
	Information Technology .....	.27-.30
	Keno .....	.31-.34
	Lotteries .....	.35-.37
	Promotions and Incentive Programs .....	.38
	Race and Sports Book (for Computerized Systems) .....	.39-.43
	Slot Machines .....	.44-.49
	Table Games .....	.50-.53
16	Analytical Procedures	.01-.12
	Introduction .....	.01-.04
	Types of Analytical Procedures .....	.05-.12
	Table Games and Poker .....	.10-.12

Appendix

- A Category B Guidance
- B The New Revenue Recognition Standard: FASB ASC 606
- C Illustrative Financial Statements
- D Illustrative Guidance When Accounting for Guarantees
- E The New Jersey Casino Reinvestment Development Authority
- F Currency Transaction Reporting in the Gaming Industry
- G Rules of the Games
- H Overview of Statements on Quality Control Standards
- I The New Leases Standard: FASB ASC 842
- J Revenue Recognition Implementation Issues
- K Schedule of Changes Made to the Text from the Previous Edition

Glossary

Index of Pronouncements and Other Technical Guidance

Subject Index

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 nonbanked 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 interstate lottery games (for example, Powerball, Mega Millions), which results in increased ticket sales and larger payouts than normally found in a single state lottery.

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

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	River-boat	Native American ²	Card room	Lottery ³	Bingo	Online Gaming	Racino ⁴	Sports Wagering ⁵	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	X	
District of Columbia					X	X				
Florida			X	X	X	X		X		

(continued)

Gaming

**Nature of Legalized Gaming Throughout the
United States — *continued***

State	Land based ¹	River-boat	Native American	Card room	Lottery	Bingo	Online Gaming	Racino	Sports Wagering	None
Georgia					X	X				
Hawaii										X
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			X	
Missouri		X	X		X	X				
Montana			X	X	X	X			X	
Nebraska			X		X	X				
Nevada	X		X			X	X		X	
New Hampshire					X	X				
New Jersey	X				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			X	
Pennsylvania	X				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	X	
Wisconsin			X		X	X				
Wyoming			X		X	X				
Number of states	12	7	30	5	45	48	3	13	8	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.
⁵ Sports betting in some form has been legalized. More states are in the process of legalizing.

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 2017, the states of Nevada, New Jersey, and Delaware have legalized online gaming conducted and operated within their state.

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 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

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.

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.
- The Professional and Amateur Sports Protection Act (PASPA) was passed in 1992 for the stated purpose of protecting the integrity of sports. As a part of the protection process, PASPA banned sports betting in all but a few U.S. states. In 2018 the Supreme Court declared the federal law unconstitutional. This leaves it up to individual states to determine the legality of sports betting.

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
- War

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 provide nonauthoritative guidance that addresses reporting on financial statements developed using an inappropriate set of standards. The Q&A sections 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&A sections:

- 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"

All Q&A sections can be found in *Technical Questions and Answers*.

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 606, Revenue from Contracts with Customers

(Note: FASB Accounting Standards Codification [ASC] 606 is not applicable to governmental entities)

The "Pending Content" that links to FASB ASC 606-10-65-1 became 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. For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

The AICPA formed 16 industry task forces to assist in developing an 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/revrec). As of the date of this publication, 17 revenue recognition implementation issues specific to the gaming industry have been identified. Of the 17 identified issues, all have been finalized and incorporated in the 2018 AICPA Audit and Accounting Guide *Revenue Recognition*. Appendix J, "Revenue Recognition Implementation Issues," of this guide

contains the finalized implementation issues as found in chapter 6, "Gaming Entities," of *Revenue Recognition*.

Introduction

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

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

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

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

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*

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.

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 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.

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.

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	
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)
<hr/>	
Gross gaming revenue (Win)*	\$ 800

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

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

Overview of the Cage and General Ledger Control

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

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

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

Overview of Incentive Programs in the Gaming Industry³

3.33 The gaming industry provides various incentives to induce customers to play, many of which allow gambling to take place without customers being required to use their own funds. For some incentive programs, an obligation 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 predetermined benefits are established or communicated to the customer (or potential customer). Discretionary programs typically are targeted to either past, current, or potential customers and may or may not be related to the level of play. Characteristics of specific programs that are described in the following

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

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 $\frac{1}{4}$ of \$0.01 — and can be exchanged for either (a) cash only, (b) complimentaries, (c) free play, or (d) a combination of all of these. Points generally can be redeemed at the customer's request, subject to availability, with few "blackout" days.
- *Players clubs*. These programs are similar to slot club loyalty programs, except that customers earn and accumulate points for playing on table games or other games in addition to playing on slots.
- *Club status (also referred to as player tracking)*. In these programs, customers earn a club status, such as a Gold, Silver, or Platinum Member rather than points. Typically, members may be eligible, subject to availability or current policy, for future complimentaries or promotions, or benefits such as preferred check-in.

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

3.36 The most typical incentive arrangement is the distribution of match play coupons, typically redeemable for 1 bet. The coupons may be distributed in a variety of ways, including but not limited to mail, a booth 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 non-governmental 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 606, Revenue from Contracts with Customers

(Note: FASB Accounting Standards Codification [ASC] 606 is not applicable to governmental entities)

The "Pending Content" that links to FASB ASC 606-10-65-1 became 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. For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

The AICPA formed 16 industry task forces to assist in developing an 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/revrec). As of the date of this publication, 17 revenue recognition implementation issues specific to the gaming industry have been identified. Of the 17 identified issues, all have been finalized and incorporated in the 2018 AICPA Audit and Accounting Guide *Revenue Recognition*. Appendix J, "Revenue Recognition Implementation Issues," of this guide contains the finalized implementation issues as found in chapter 6, "Gaming Entities," of *Revenue Recognition*.

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 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

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

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, the AICPA Financial Reporting Executive Committee (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 non-governmental 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 606, Revenue from Contracts with Customers

(Note: FASB Accounting Standards Codification [ASC] 606 is not applicable to governmental entities)

The "Pending Content" that links to FASB ASC 606-10-65-1 became 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. For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

The AICPA formed 16 industry task forces to assist in developing an 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/revrec). As of the date of this publication, 17 revenue recognition implementation issues specific to the gaming industry have been identified. Of the 17 identified issues, all have been finalized and incorporated in the 2018 AICPA Audit and Accounting Guide *Revenue Recognition*. Appendix J, "Revenue Recognition Implementation Issues," of this guide contains the finalized implementation issues as found in chapter 6, "Gaming Entities," of *Revenue Recognition*.

Background

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

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

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

Summary of Selected Accounting Literature

5.04 The primary accounting guidance relating to participation and similar arrangements is described in 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.

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.

Ⓒ 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, 2020.

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 and subsequent developments, 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 non-governmental 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 606, Revenue from Contracts with Customers

(Note: FASB Accounting Standards Codification [ASC] 606 is not applicable to governmental entities)

The "Pending Content" that links to FASB ASC 606-10-65-1 became 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 non-financial 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. For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

The AICPA formed 16 industry task forces to assist in developing an 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/revrec). As of the date of this publication, 17 revenue recognition implementation issues specific to the gaming industry have been identified. Of the 17 identified issues, all have been finalized and incorporated in the 2018 AICPA Audit and Accounting Guide *Revenue Recognition*. Appendix J, "Revenue Recognition Implementation Issues," of this guide contains the finalized implementation issues as found in chapter 6, "Gaming Entities," of *Revenue Recognition*.

Summary of Selected Accounting Literature

6.01 FASB, the AICPA Financial Reporting Executive Committee (Fin-REC), 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.

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.

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

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

6.06 In circumstances in which the 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 complimentary.

6.10 For nondiscretionary incentive programs, FinREC believes it is acceptable practice to report these programs using either (a) a deferred revenue model or (b) an immediate revenue/cost accrual model. FinREC believes the deferred revenue model is appropriate in all circumstances, whereas the immediate revenue/cost accrual model is acceptable in only certain circumstances. For example, FinREC believes an immediate revenue/cost accrual model is inappropriate in circumstances in which (a) a significant number of paying customers are displaced by customers redeeming awards,² or (b) the value of an individual award is significant compared with the purchase earning the award.

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.

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.

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.

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.

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.

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

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 that the incremental cost of \$100 of complimentaries 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 complimentaries, 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 complimentaries.

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,

complimentaries, or other economic benefits, though that status may lead to complimentaries or other benefits, subject to the approval of management. Such programs generally do not result in an accounting recognition prior to offering such benefits because no obligation exists to transfer resources to customers.

Financial Statement Disclosures

6.29 Generally, policies pertaining to accounting for loyalty and incentive programs are disclosed in 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 non-governmental 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.

Background¹

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.

¹ See appendix J, "Revenue Recognition Implementation Issues," of this guide for information related to chapter content.

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 commitments² 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.³ 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.

² 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.

³ 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.

7.09 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.

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 non-governmental 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 606, Revenue from Contracts with Customers

(Note: FASB Accounting Standards Codification [ASC] 606 is not applicable to governmental entities)

The "Pending Content" that links to FASB ASC 606-10-65-1 became 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. For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

The AICPA formed 16 industry task forces to assist in developing an 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/revrec). As of the date of this publication, 17 revenue recognition implementation issues specific to the gaming industry have been identified. Of the 17 identified issues, all have been finalized and incorporated in the 2018 AICPA Audit and Accounting Guide *Revenue Recognition*. Appendix J, "Revenue Recognition Implementation Issues," of this guide contains the finalized implementation issues as found in chapter 6, "Gaming Entities," of *Revenue Recognition*.

Background

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

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

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

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

Summary of Selected Accounting Literature

8.05 The primary accounting literature relating to amounts incurred related to management contracts is 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 The AICPA Financial Reporting Executive Committee (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.

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

Accounting by the Gaming Entity Managing the Third Party Owned Property

Gaming Entity's Costs Prior to Obtaining the Management Agreement

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

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

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

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

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

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.

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.

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.

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

⁴ See footnote 3.

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

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
- 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 non-governmental 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 606, Revenue from Contracts with Customers

(Note: FASB Accounting Standards Codification [ASC] 606 is not applicable to governmental entities)

The "Pending Content" that links to FASB ASC 606-10-65-1 became 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. For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

The AICPA formed 16 industry task forces to assist in developing an 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/revrec). As of the date of this publication, 17 revenue recognition implementation issues specific to the gaming industry have been identified. Of the 17 identified issues, all have been finalized and incorporated in the 2018 AICPA Audit and Accounting Guide *Revenue Recognition*. Appendix J, "Revenue Recognition Implementation Issues," of this guide contains the finalized implementation issues as found in chapter 6, "Gaming Entities," of *Revenue Recognition*.

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 an 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.

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 The AICPA Financial Reporting Executive Committee (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):

¹ For additional guidance, refer to FASB *Accounting Standards Codification* 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.

- 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 non-governmental 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.
-

Chapter 11

Other Accounting Topics

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

FASB Accounting Standards Codification 606, Revenue from Contracts with Customers

(Note: FASB Accounting Standards Codification [ASC] 606 is not applicable to governmental entities)

The "Pending Content" that links to FASB ASC 606-10-65-1 became 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. For more information, see appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide.

The AICPA formed 16 industry task forces to assist in developing an 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/revrec). As of the date of this publication, 17 revenue recognition implementation issues specific to the gaming industry have been identified. Of the 17 identified issues, all have been finalized and incorporated in the 2018 AICPA Audit and Accounting Guide *Revenue Recognition*. Appendix J, "Revenue Recognition Implementation Issues," of this guide contains the finalized implementation issues as found in chapter 6, "Gaming Entities," of *Revenue Recognition*.

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.

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

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.

- 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.

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.

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

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

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

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

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

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

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.

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.
-

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*.

Ⓢ Update 12-1 Accounting and Reporting: Leases

GASB Statement No. 87, *Leases*, will change the accounting and financial reporting for leases in governmental financial statements. One of the principal changes established by this statement is the use of a single model for lease accounting rather than the historical approach of classifying leases as either *operating* or *capital leases*. This approach is based on the principle that leases are financings of the right to use an underlying asset. The statement will require recognition of certain lease assets and liabilities for leases that were previously classified as operating leases.

Lessors will continue to record the actual leased asset after lease inception. Lessors will recognize a lease receivable and a deferred inflow of resources at the start of the lease term, with exceptions for leases of assets held as investments, certain regulated leases, short-term leases, and leases that transfer ownership of the underlying asset. Lessors will also recognize lease revenue and interest revenue on the receivable, and provide note disclosures about the lease. Note disclosures include a general description of the leasing arrangement and the total amount of inflows of resources recognized from leases.

The statement was issued in June 2017 and is effective for reporting periods beginning after December 15, 2019.

Upon its effective date, GASB Statement No. 87 will result in new guidance related to leases of capital assets as described in this chapter. Lease liabilities will be reported for all leases meeting the criteria without regard to or distinction as either operating or capital leases.

The full text of the statement is available on GASB's website at www.gasb.org.

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.

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

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 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

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.

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

© **Update 12-2 Accounting and Reporting: Majority Equity Interests**

GASB Statement No. 90, *Majority Equity Interests—an Amendment of GASB Statements No. 14 and No. 61*, clarifies the accounting and financial reporting requirements for a state or local government's majority equity interest in an organization that remains legally separate after acquisition.

Under GASB Statement No. 90, a government's majority equity interest in a legally separate organization should be reported as an investment if that equity interest meets the GASB's definition of an investment. In many instances, a majority equity interest that meets the definition of an investment should be measured using the equity method.

GASB Statement No. 72, *Fair Value Measurement and Application*, defines an *investment* 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."

For a majority equity interest in a legally separate entity that does not meet the definition of an investment, GASB Statement No. 90 requires a government to report the legally separate entity as a component unit.

GASB Statement No. 90 also establishes guidance for remeasuring assets and liabilities of wholly acquired governmental organizations that remain legally separate. That guidance brings the reporting of those acquisitions in line now with existing standards that apply to acquisitions that do not remain legally separate.

The statement was issued in August 2018 and is effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

The full text of the statement is available on GASB's website at www.gasb.org.

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.

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
- 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,

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*.

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.

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

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*,³ 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.

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.

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 U.S. Government Accountability Office. The AICPA Audit Guide Government Auditing Standards and Single Audits discusses Government Auditing Standards requirements and guidance related to financial audits.

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

³ All AU-C sections can be found in AICPA *Professional Standards*.

Terms of Engagement

13.05 AU-C section 210, *Terms of Engagement*, 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*, 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*, 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*⁴ 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

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

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*, 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)*. Planning an audit involves establishing the overall audit strategy for 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*; 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*; 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.
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.

(continued)

Categories of Assertions — *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>
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.

Materiality⁵

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.

13.26 AU-C section 320, *Materiality in Planning and Performing an Audit*, 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*, 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

⁵ Chapter 4 of the AICPA's Audit and Accounting Guide *State and Local Governments* contains guidance on materiality as it relates to governmental entities.

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.⁶

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).

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.

⁶ AU-C section 530, *Audit Sampling*, defines tolerable misstatement and provides further application guidance about the concept.

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*. 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.⁷

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

⁷ See paragraph 13.144 for information on AU-C section 610, *Using the Work of Internal Auditors*.

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*, 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.⁸

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 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,

⁸ FASB *Accounting Standards Codification* (ASC) 850-10-50-5 states that if representations are made about transactions with related parties, the representations should not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's length transactions unless such representations can be substantiated.

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.⁹

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, 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

⁹ 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.

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*, 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).¹⁰ However, factors which may mitigate the risk when

¹⁰ For information regarding identifying significant auditing considerations relevant to auditing revenue under FASB ASC 606, *Revenue from Contracts with Customers*, for nongovernmental entities, see the AICPA Audit and Accounting Guide *Revenue Recognition*. Appendix J, "Revenue Recognition Implementation Issues," of this guide presents chapter 6, "Gaming Entities," of *Revenue Recognition*.

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.

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*, 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 a 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*, 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*, 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)¹¹ 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

¹¹ Technical Questions and Answers (Q&A) section 8200.06, "The Meaning of Expectation of the Operating Effectiveness of Controls," 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.

All Q&A sections can be found in *Technical Questions and Answers*.

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, 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*, 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*, 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;¹² 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.¹³

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

¹² 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* .

¹³ A firm of independent auditors has a responsibility to adopt a system of quality control policies and procedures to provide the firm with reasonable assurance that its personnel comply with applicable professional standards, including GAAS, and the firm's standards of quality in conducting individual audit engagements. Review of audit documentation and discussions with engagement team members are among the procedures a firm performs when monitoring compliance with the quality control policies and procedures that it has established. The elements of quality control are identified in paragraphs .17–.19 of AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- 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 email) 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*, 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*, 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^{14,15} 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 500.¹⁶

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.

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.

¹⁴ Paragraphs .A10 and .A20–.A22 of AU-C section 220.

¹⁵ Paragraph .12 of AU-C section 300, *Planning an Audit*.

¹⁶ Paragraphs .A35–.A49 of AU-C section 500, *Audit Evidence*.

13.151 AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, 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, *Written Representations*, 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,¹⁷ 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.

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*, or withdraw from the engagement if

¹⁷ As stated in paragraph .02 of AU-C section 580, *Written Representations*, 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.

- 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*, 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*, 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*, 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 Concern¹⁸

13.167 AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, 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. Paragraph .02 of AU-C section 570 states that under the going concern basis of accounting, the financial statements are 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.

13.168 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.

13.169 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

¹⁸ 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.

- 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.

13.170 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

13.171 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.

13.172 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

13.173 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

13.174 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

13.175 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.

13.176 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

13.177 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.

13.178 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

13.179 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.

13.180 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*.

Communicate With Those Charged With Governance

13.181 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

13.182 Paragraph .32 of AU-C section 570 states that if conditions or events are identified that, when considered in the aggregate, raise substantial

doubt about the entity's ability to continue as a going concern for a reasonable time before consideration of management's plans, 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 conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, if applicable.
- c. The auditing procedures performed to evaluate the significant elements of management's plans and evidence obtained, if applicable.
- 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 should also document the auditor's 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 and management's plans that alleviated the substantial doubt.
- e. The auditor's conclusion with respect to the effects on the auditor's report.

Group Audit Engagements

13.183 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.

13.184 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.

13.185 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

13.186 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.

13.187 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

13.188 Q&A section 8800, *Audits of Group Financial Statements and Work of Others*, provides technical answers to common group audit questions.

Other Information, Supplementary Information, and Required Supplementary Information

13.189 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*, 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.

13.190 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*, 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.

13.191 AU-C section 730, *Required Supplementary Information*, addresses the auditor's responsibility with respect to information that a designated accounting standard setter requires to accompany an entity's basic financial statements (hereinafter referred to as *required supplementary information or RSI*). 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.

13.192 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*.

13.193 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*,² 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*, and AU-C section 500, *Audit Evidence*. 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

² All AU-C sections can be found in AICPA *Professional Standards*.

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*.

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,³ 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

³ The effects on aging when current markers merely replace older ones is a consideration when testing.

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 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.
-

Chapter 16

Analytical Procedures

Introduction¹

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

¹ See appendix J, "Revenue Recognition Implementation Issues," of this guide for terminology and other revisions applicable to nongovernmental entities resulting from the implementation of FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers (Topic 606)*. Guide content will be updated in a future edition.

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*² per table.
 - *Drop*³ 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

² 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.

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

- Poker
 - Win comparison to the same month last year
 - Win comparison to the previous month
- Relationships with other departments (not limited to the following), if applicable:
 - Hotel
 - Food and beverage
 - Retail
 - Conventions
 - Entertainment
- Relationships with outside conditions
 - Traffic flow
 - Weather
 - 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 12.19-.21	Indicators of impairment of a governmental gaming entity's capital assets	1400.801-.803

Appendix B

The New Revenue Recognition Standard: FASB ASC 606

Note: See appendix J, "Revenue Recognition Implementation Issues," of this guide for important information regarding revenue recognition guidance as it relates specifically to the gaming industry. The guidance in FASB Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, and the revenue recognition implementation issues found in appendix J, will affect content in a number of places throughout this guide, including content in chapters, appendixes, and the glossary. The content of this guide will be updated in a future edition.

This appendix is nonauthoritative and is included for informational purposes only. Note that FASB ASC 606 does not apply to governmental entities.

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.

Subsequent Developments

Subsequent to the issuance of ASU No. 2014-09, FASB 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.

FASB 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.

FASB also issued ASU No. 2017-13, *Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments (SEC Update)*, in September 2017. The amendments in this ASU state that public entities that do not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC may adopt the effective date for nonpublic entities.

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. In addition, the AICPA continues to update the Audit and Accounting Guide *Revenue Recognition* to include key accounting implementation issues across 16 industry task forces. Although the implementation issues have not all been finalized across the 16 task forces, this guide is currently available

for purchase at www.aicpastore.com/Accounting/revenue-recognition—audit-and-accounting-guide/PRDOVR-PC-012516/PC-012516.jsp, including updates to the guide as they become available.

See appendix J of this guide for the finalized revenue recognition issues implementation issues related to gaming.

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 Entity¹

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

¹ These financial statements do not include any revisions that will be required upon the effective date of FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers (Topic 606)*. See appendix J, "Revenue Recognition Implementation Issues," of this guide for information on the revisions related to some financial statement line items under FASB Accounting Standards Codification (ASC) 606, *Revenue From Contracts With Customers*.

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.²

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]³

[Date of the auditor's report]

² 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*, 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.

All AU-C sections can be found in *AICPA Professional Standards*.

³ For clarification regarding the naming of the city and state on the auditor's report refer to Technical Questions and Answers (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."

All Q&A sections can be found in *Technical Questions and Answers*.

ABC Casinos, Inc.
Balance Sheets

	<i>December 31,</i>	
	<i>20X2</i>	<i>20X1</i>
<i>Assets</i>		
Current assets		
Cash and cash equivalents	\$5,678,300	\$3,787,100
Accounts receivable, less allowance for uncollectible accounts of \$500,000 and \$470,000	1,800,100	1,695,200
Other current assets	240,700	229,100
Total current assets	7,719,100	5,711,400
Property and equipment, at cost		
Land	2,201,100	2,201,100
Buildings	27,602,300	27,602,300
Furniture and equipment	9,581,100	8,995,200
Total	39,384,500	38,798,600
Less accumulated depreciation	(9,000,600)	(7,100,985)
Net property and equipment	30,383,900	31,697,615
Other assets and deferred charges, net	1,300,000	1,200,000
Total assets	\$39,403,000	\$38,609,015
<i>Liabilities and Stockholders' Equity</i>		
Current liabilities		
Current portion of long-term debt	\$1,000,000	\$700,000
Accounts payable	928,600	839,200
Income taxes payable	150,000	161,000
Other	344,400	207,600
Total current liabilities	2,423,000	1,907,800
Long-term debt, less current portion	15,800,000	16,800,000
Deferred income taxes	1,068,200	876,000
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.

ABC Casinos, Inc.
Statements of Income and Retained Earnings

	<i>Year ended December 31,</i>	
	<i>20X2</i>	<i>20X1</i>
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
	20,003,200	17,999,500
Less: Promotional allowances	(2,109,400)	(1,858,400)
Net Revenues	17,893,800	16,141,100
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	13,336,715	12,122,731
Operating income	4,557,085	4,018,369
Interest expense	(2,050,300)	(1,935,300)
Income before income taxes	2,506,785	2,083,069
Less provision for income taxes	(970,200)	(818,000)
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)	(450,000)	(450,000)
Retained earnings, December 31	\$12,616,000	\$11,529,415

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

ABC Casinos, Inc.
Statements of Cash Flows

	<i>Years ended December 31,</i>	
	<i>20X2</i>	<i>20X1</i>
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	4,330,200	4,075,500
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	(1,289,000)	2,100
Cash flows from financing activities:		
Repayment of long-term debt	(700,000)	(1,000,000)
Dividends	(450,000)	(450,000)
Net cash used in financing activities	(1,150,000)	(1,450,000)
Net increase in cash and cash equivalents	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	\$5,678,300	\$3,787,100
Supplemental disclosure of cash flow data:		
Cash paid during the years for:		
Interest (net of amounts capitalized)	\$2,000,000	\$1,800,000
Income taxes	\$789,000	\$634,300

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

ABC Casinos, Inc.
Notes to Financial Statements

1. Nature of Operations

ABC Casinos, Inc. (the Company) offers gaming, lodging, and restaurant services to its customers through the ownership and/or operation of casino-hotel resorts in Las Vegas, Nevada and Tunica, Mississippi. The Company earns a portion of its revenue from the management of casinos for other entities. The major source of the company's revenues is derived from gaming operations. The company is subject to regulation and taxation by the states in which it operates, generally managed through state agencies specifically established to control the conduct of gaming activities in that state. The company is subject to certain other local and federal regulations as well.

2. Summary of Significant Accounting Policies

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates for the Company include the allowance for uncollectible accounts receivable; useful lives assigned to property, plant, and equipment; and 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	\$1,610,100	\$190,000	\$1,800,100
<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	\$1,563,200	\$132,000	\$1,695,200

Receivables consist primarily of large groups of smaller-balance homogeneous accounts that are collectively evaluated for impairment.

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	\$2,109,400	\$1,858,400

5. Long-Term Debt

Long-term debt is summarized as follows:

	<i>20X2</i>	<i>20X1</i>
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

	20X2	20X1
Notes payable, other, 1% over prime, payable to 20X6	4,500,000	4,600,000
Total long-term debt	16,800,000	17,500,000
Less current installments of long-term debt	(1,000,000)	(700,000)
Net long-term debt	\$15,800,000	\$16,800,000

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	3,956,000
	\$16,800,000

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.

Governmental Gaming Entity

Illustrative financial statements and footnotes of a *governmental gaming entity* directly follow the Independent Auditor's Report.

⁴ Readers may refer to FASB 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).

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.

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

⁶ See footnote 2.

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.

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*, 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	7,719,100	5,711,400
Capital assets, net of accumulated depreciation	30,383,900	31,697,615
Other assets	1,300,000	1,200,000
Total assets	\$39,403,000	\$38,609,015
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	2,873,075	2,282,800
Long-term debt	15,800,000	16,800,000
Other	618,125	501,000
Total liabilities	19,291,200	19,583,800
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	20,111,800	19,025,215
Total liabilities and net position	\$39,403,000	\$38,609,015

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>	
	<i>20X2</i>	<i>20X1</i>
Operating Revenues¹²		
Gaming	\$13,802,300	\$12,532,100
Rooms	2,100,600	1,927,200
Food and beverage	1,300,300	1,139,700
Other	690,600	542,100
Total operating revenues	17,893,800	16,141,100
Operating Expenses		
Gaming	4,012,100	3,717,600
Rooms	1,800,000	1,600,000
Food and beverage	1,500,000	1,200,000
Other	400,000	300,000
Selling, general, and administrative	3,021,900	2,707,700
State revenue sharing	970,200	818,000
Depreciation	2,602,715	2,597,431
Total operating expenses	14,306,915	12,940,731
Operating income	3,586,885	3,200,369
Nonoperating Revenues (Expenses)		
Interest expense	(2,050,300)	(1,935,300)
Total nonoperating revenues (expenses)	(2,050,300)	(1,935,300)
Income before transfers	1,536,585	1,265,069
Transfers to XYZ tribe^{13,14}		
Gaming taxes and regulation	250,000	250,000
Other	200,000	200,000
	450,000	450,000
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	\$20,811,800	\$19,025,215

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 December 31,</i>	
	<i>20X2</i>	<i>20X1</i>
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	6,330,200	6,010,800
Cash flows from noncapital financing activities		
Transfers to XYZ Tribe	(450,000)	(450,000)
Net cash used in noncapital financing activities	(450,000)	(450,000)
Cash flows from capital and related financing activities		
Purchases of capital assets	(1,295,200)	(435,200)
Proceeds from sales of capital assets	6,200	437,300
Principal payments on long-term debt	(700,000)	(1,000,000)
Interest paid on debt	(2,000,000)	(1,935,300)
Net cash used in capital and related financing activities	(3,989,000)	(2,933,200)
Net increase in cash and cash equivalents	1,891,200	2,627,600
Cash and cash equivalents, beginning of year	3,787,100	1,159,500
Cash and cash equivalents, end of year	\$5,678,300	\$3,787,100
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	\$6,330,200	\$6,010,800

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>	
	<i>20X2</i>	<i>20X1</i>
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	\$5,678,300	\$3,787,100

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>
<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	\$1,610,100	\$190,000	\$1,800,100
<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	\$1,563,200	\$132,000	\$1,695,200

Receivables consist primarily of large groups of smaller-balance homogeneous accounts that are collectively evaluated for impairment.

5. Long-Term Debt

Long-term debt consists of notes payable by XYZ Tribe to various financial institutions summarized as follows:

	<i>20X2</i>	<i>20X1</i>
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	4,500,000	4,600,000
Total long-term debt	16,800,000	17,500,000
Less current installments of long-term debt	1,000,000	700,000
Net long-term debt	\$15,800,000	\$16,800,000

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

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.

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

(continued)

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

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

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

	Principal	Interest	Total
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
	\$16,800,000	\$3,419,570	\$20,219,570

6. Capital Assets

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

	Year Ended December 31, 20X2			Ending Balance
	Beginning Balance	Increases	Decreases	
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
	38,798,600	1,295,200	709,300	39,384,500

Less: accumulated depreciation

(continued)

(footnote continued)

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.

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.

Gaming

	<i>Year Ended December 31, 20X2</i>			
	<i>Beginning Balance</i>	<i>Increases</i>	<i>Decreases</i>	<i>Ending Balance</i>
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
	7,100,985	2,602,715	703,100	9,000,600
Capital assets, net	\$31,697,615	\$(1,307,515)	\$6,200	\$30,383,900

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

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 Guarantees¹

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

Applicability: *This appendix provides guidance applicable to non-governmental 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

¹ This appendix does not include any revisions that will be required upon the effective date of FASB Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. See appendix B, "The New Revenue Recognition Standard: FASB ASC 606," and appendix J, "Revenue Recognition Implementation Issues," of this guide for information on revisions related FASB *Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers*.

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

<i>Year</i>	<i>New Casino's Projected Operating Earnings</i>	<i>Gaming Manager's Estimated Management Fee (10%)</i>
1	\$7,700,000	\$770,000
2	8,000,000	800,000
3	8,350,000	835,000
4	8,600,000	860,000
5	9,000,000	900,000
Total	\$41,650,000	\$4,165,000

In example 1, the issuance of the guarantee obligates the Gaming Manager in two respects: (a) the Gaming Manager undertakes an obligation to stand ready to perform and (b) the Gaming Manager undertakes a contingent obligation to make future payments if certain triggering events or conditions occur. Thus, at inception, the Gaming Manager should recognize a liability for the greater of (a) the fair value of the guarantee, or (b) the contingent liability amount required to be recognized at inception of the guarantee provided by FASB ASC 450-20-25-2, as explained in FASB ASC 450, *Contingencies*. For purposes of this example, it is assumed that no evidence exists that it is probable that the Gaming Manager has incurred an estimated loss from a contingency pursuant

to FASB ASC 450-20-25-2. As a result, the Gaming Manager should record the inception liability at fair value.

The management agreement provides that the management fee will be reduced from 10 percent to 7 percent if the Gaming Manager is no longer required to guarantee the Casino Owner's debt. Given this contractual provision, the present value of the estimated reduction in management fees that would occur (based on contracted amounts), if the manager is no longer required to provide the guarantee, may provide a reasonable estimate of how much of the total fee should be allocated to the premium that would be required by the manager to issue the same guarantee in a stand-alone, arm's length transaction with an unrelated party. Based on the estimated management fees to be earned by the Gaming Manager over the term of the management agreement as outlined in the previous table, the portion of the total management fee ascribed to the premium for providing the guarantee may be reasonably estimated as follows:

Table D-2

<i>Year</i>	<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.²

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.

² Pursuant to FASB ASC 360-10-35-21, as explained in FASB ASC 360, *Property, Plant, and Equipment*, the reduction in management fees would be a change in circumstances indicating that the carrying amount of the contract acquisition cost asset may not be recoverable. Accordingly, the customer acquisition cost asset (asset group) should be tested for impairment in conformity with FASB ASC 360. This example assumes no such impairment exists.

In such circumstances, two transactions have occurred and are accounted for separately. The first transaction is the termination of the guarantee, similar to the transaction described in example 4. The second transaction is the issuance of the new guarantee in exchange for the extension of the management contract.

As a result of the termination of the original guarantee, the Gaming Manager should make the following entry to reduce the guarantee liability to zero because the original guarantee no longer exists:

Dr	Guarantee liability	215,600	
	Cr Management contract revenue (or other income)		215,600

To eliminate the guarantee liability balance against revenue because the original guarantee (and related liability) no longer exists.

Given that the portion of the management fee attributable to providing the guarantee in future periods is used to support the contract acquisition asset recognized in the following entry, the Gaming Manager should also write off the remaining balance of the existing contract acquisition asset due to the modification of the agreement (see example 9.)

Dr	Management contract revenue (or other expense)	215,600	
	Cr Contract acquisition cost asset		215,600

To write off the remaining balance of the intangible asset [(\$1,078,000 initially reported – \$862,400 amortized to date) = \$215,600 balance after year 4] as a result of the modification of the agreement.

The Gaming Manager would then calculate the fair value of the new guarantee pursuant to the terms of the new agreement and record a new contract acquisition cost asset and new guarantee liability as described in example 1. The asset and liability would be amortized over the lives of the modified management contract and the new guarantee, respectively.

Example 6: Change in expected operating results — it is probable that the Casino Owner will default.

Additional hypothetical data for example 6: In this example, assume facts and circumstances described in example 1, except that that the loan is an amortizing 5-year loan with annual principal payments. The Gaming Manager concludes that both the guarantee liability and the intangible asset should be amortized using the straight-line method. Further, assume that as of the end of year 1, the Casino Owner has made no debt payments and, based on operating results to date and management estimates, the Gaming Manager concludes that it is probable that the Casino Owner will default on the debt; the bank will demand that the Gaming Manager satisfy the debt; the Casino Owner will go out of business; and the management agreement will not be fulfilled. In this circumstance, the Gaming Manager has incurred an estimated loss from a contingency pursuant to FASB ASC 450-20-25-2 for having to perform under the guarantee. In addition, the Gaming Manager has incurred an impairment loss pursuant to FASB ASC 360, *Property, Plant, and Equipment*, for the contract acquisition cost asset (asset group). The contract acquisition cost asset should

be eliminated and an impairment loss reported in conformity with FASB ASC 360, including related financial statement disclosures. The Gaming Manager should make the following entries:

Dr	Impairment loss	862,400	
	Cr	Contract acquisition cost asset	862,400

To report an impairment loss pursuant to FASB ASC 360 and, therefore, eliminate the intangible asset balance [\$1,078,000 initially reported – \$215,600 relieved to date].

Dr	Guarantee liability	\$862,400	
Dr	Loss on guarantee	24,137,600	
	Cr	Contingent liability	\$25,000,000

To report a loss for the amount of the guaranteed debt in excess of the guarantee liability.

Example 7: A change in the expected operating results — the Casino Owner performs better than expected.

Additional hypothetical data for example 7: In this example, the gaming manager is reducing the guarantee liability on a straight-line basis over the 5-year period of the original guarantee (with a proportionate reduction of the liability if a portion of the debt is prepaid, or the manager is released from the guarantee obligation), similar to the fact pattern in example 3. After year 1, based on better than expected operating results to date and management estimates, the Gaming Manager concludes that it is likely that it will be released from the guarantee after year 2, and that the fair value of the guarantee will be significantly less than originally estimated at inception. The Gaming Manager considers reducing the liability on an accelerated basis (beyond amounts that would be reported by reducing the liability on a straight-line basis over the 5-year period of the original guarantee) because its risk has been significantly reduced beyond amounts that would be reported based on a straight-line calculation. The Gaming Manager concludes, however, that it should not reduce the liability on an accelerated basis, consistent with FASB ASC 460-10-35-2, as explained in FASB ASC 460.³ 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.

³ 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
	\$41,650	\$4,165	\$1,250		\$1,078

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>Annual Interest</i>			<i>Discounted at 5% Annually</i>	<i>Discounted Value</i>
	<i>Stated Interest</i>	<i>Without Guarantee</i>	<i>Difference</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
					\$1,082

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
			\$(25,000)		\$1,078

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
		\$4,165	\$1,078

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 non-governmental 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*;² 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 Bonds³

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

² FASB Accounting Standards Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, moves the guidance related to equity securities to FASB *Accounting Standards Codification (ASC) 321, Investments—Equity Securities*, upon its effective date.

³ Casino Reinvestment Development Authority bonds are not backed by the full faith and guarantee of the state of New Jersey.

measurement date.⁴ Generally, the fair value of the initial obligation deposit is less than its face amount because (1) its use is restricted to either purchase 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 investment⁵ 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 320,⁶ 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.

⁴ For additional guidance, refer to FASB ASC 820-10-65-4, as explained in FASB ASC 820, *Fair Value Measurements and Disclosures*.

⁵ 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.

⁶ For additional guidance, refer to FASB ASC 320-10-65-1.

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 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
-

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*.² 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

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.

² All AU-C sections can be found in AICPA *Professional Standards*.

transmitting and receiving funds transfers directly from other financial institutions. As a result of this risk, various laws enacted to prevent money laundering are applicable to casinos. In order to mitigate risk and to support national and international efforts against financial crime, it is important that casinos and auditors have a basic understanding of how money laundering schemes can operate. Many of the same controls used by casinos for purposes of protecting their assets and marketing to customers may be used to detect and prevent money laundering. Various requirements of federal regulations promulgated through the years have enhanced these internal controls.

Federal currency transaction regulations for casinos require monitoring of customer transactions using procedures that casinos routinely utilize in the normal course of their business. Casinos are always interested in knowing their customers in order to market to them for future visits and to provide complimentary commensurate with the policies of the casino for the level of play of the customer. They also attempt to monitor the customer's gambling activity, including the status of the customer's cash and credit play. For instance, a large credit player might visit the cage with the residual of the chips they obtained with a marker taken at a table game. Casinos prefer that patrons pay off marker debts rather than leaving with cash while the casino maintains a receivable. Similarly, if a customer made a deposit of cash with the casino against which the customer was to play by signing several markers at a table game against that cash deposit, the casino may segregate the specific currency deposited by the customer and return those bills when the customer deposit was refunded at the cage, rather than converting the deposit to different currency or into a financial instrument. These procedures are established by the casino to prevent activity that is not in their best interests. Although the gaming industry desires to accommodate the needs of their customers for purposes of gaming, they do not want to function as a bank for their customers, nor do the casinos want customers to use the casino cage for large currency exchanges or to use the gaming operation as a conduit for large wire transfers into and out of the casino with little or no gambling activity.

Money laundering can be a complex process. It involves three different, and sometimes overlapping, stages:

- *Placement* involves physically placing illegally obtained money into the financial system or the retail economy. Money is most vulnerable to detection and seizure during the placement stage.
- *Layering* involves separating the illegally obtained money from its criminal source by layering it through a series of financial transactions, which makes it difficult to trace the money back to its original source.
- *Integration* involves moving the proceeds into a seemingly legitimate form. Integration may include, for example, the purchase of automobiles, businesses, and real estate.

An important factor connecting the three stages of this process is the paper trail generated by financial transactions. Criminals try to avoid leaving this paper trail by attempting to circumvent reporting and recordkeeping requirements. Money launderers avoid reporting and recordkeeping requirements by "structuring" transactions, coercing or bribing employees not to file proper reports

or complete required records, or by establishing apparently legitimate "front" businesses to open accounts or establish preferred customer relationships.

Bank Secrecy Act Regulations

In the United States, anti-money laundering legislation was first created in 1970 with the passage of the Bank Secrecy Act (BSA). This act required bankers to keep records and file reports about certain cash transactions. In 1985, the U.S. Department of the Treasury (Treasury) adopted regulations requiring the reporting of cash transactions by casinos. Congress passed the Money Laundering Control Act of 1986, which criminalized the act of money laundering. This was followed by the Annunzio-Wiley Anti-Money Laundering Act in 1992, and the Money Laundering Suppression Act of 1994, which added *casinos* to the definition of *financial institutions* in law (*Money and Finance, U.S. Code Title 31 Section 5312*). Following the terrorist attacks of September 11, 2001, the USA PATRIOT Act of 2001 (Patriot Act) substantially amended, and increased awareness of, the core BSA requirements and, once again, focused on the ability of financial institutions to combat money laundering and terrorist financing. As with many criminal activities, other legislation may be enacted in the future.

The Financial Crimes Enforcement Network (FinCEN) 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*;³ 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

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

Gaming

- Records of each advice, request, or instruction with respect to a transaction of any monetary value involving persons, accounts, or places outside the United States
 - Records prepared or used to monitor a customer's gaming activity (for example, player rating records, multiple transaction logs)
-

Appendix G

Rules of the Games¹

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.

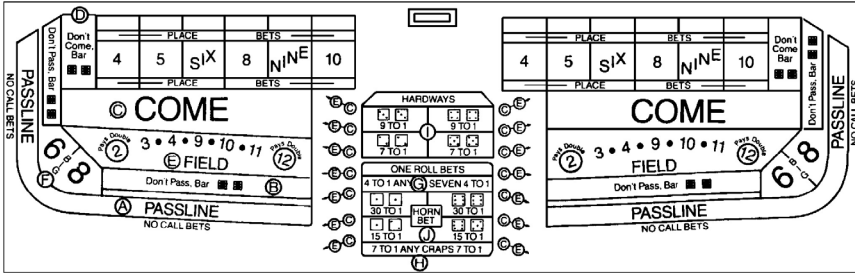
Don't Pass Line (B). The Don't Pass Line bet is the opposite of the Pass Line bet; that is, the bet wins automatically on the Come Out Roll if a 2 or 3 is rolled and loses automatically if a 7 or an 11 is rolled. A roll of 12 is a standoff on the Don't Pass Line (in some casinos, a roll of a 2 is a standoff, 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

¹ This appendix does not include any revisions that will be required for nongovernmental entities upon the effective date of FASB Accounting Standards Update 2014-09, *Revenue From Contracts With Customers (Topic 606)*. See appendix B, "The New Revenue Recognition Standard: FASB ASC 606," and appendix J, "Revenue Recognition Implementation Issues," of this guide for information on revisions related to FASB Accounting Standards Codification 606, *Revenue From Contracts With Customers*.

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.

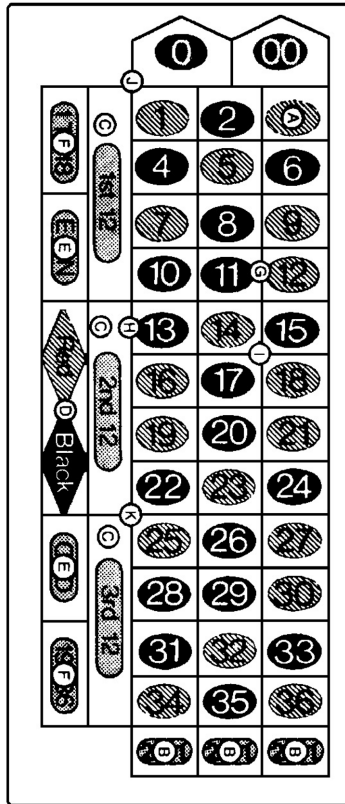
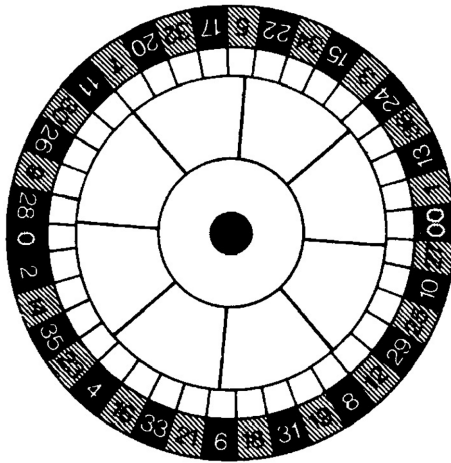
Insurance. If the dealer's up card is an ace, a player may elect to *take insurance* by placing, on the insurance line, a bet not greater than one-half of his original bet. The insurance bet is a wager that the dealer has blackjack. Insurance bets pay 2 to 1 if the dealer has blackjack, but they lose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

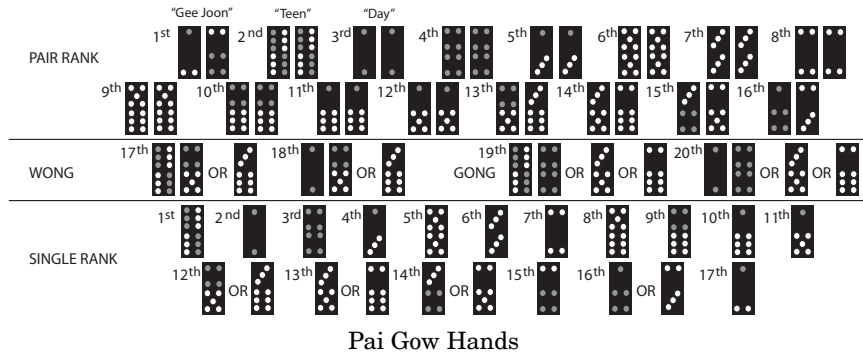
Pai Gow Tiles is an Asian game using dominoes, or tiles. The object of the game is to have both the high hand and the low hand be higher than the banker's hands (the banker is not necessarily the dealer). A banker is chosen by rolling a pair of dice and counting counterclockwise from the dealer. A player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

<i>Spread</i>	<i>Payout</i>
1	5 to 1
2	4 to 1
3	2 to 1
4–11	1 to 1

If the first two cards dealt are consecutive, the game is tied, and the player keeps his original bet. If the first two cards are the same, betting stops. If the third card makes it three of a kind, the player is paid at 11 to 1. If the third card does not make it three of a kind, the player loses.

Sic Bo

Sic Bo is a dice game with an Asian origin. Essentially, players can place multiple bets on various outcomes, totals, and combinations of rolling three dice. Payouts are listed as the following:

Sic Bo Payout Odds

<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	4 and 5	4 and 6	5 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

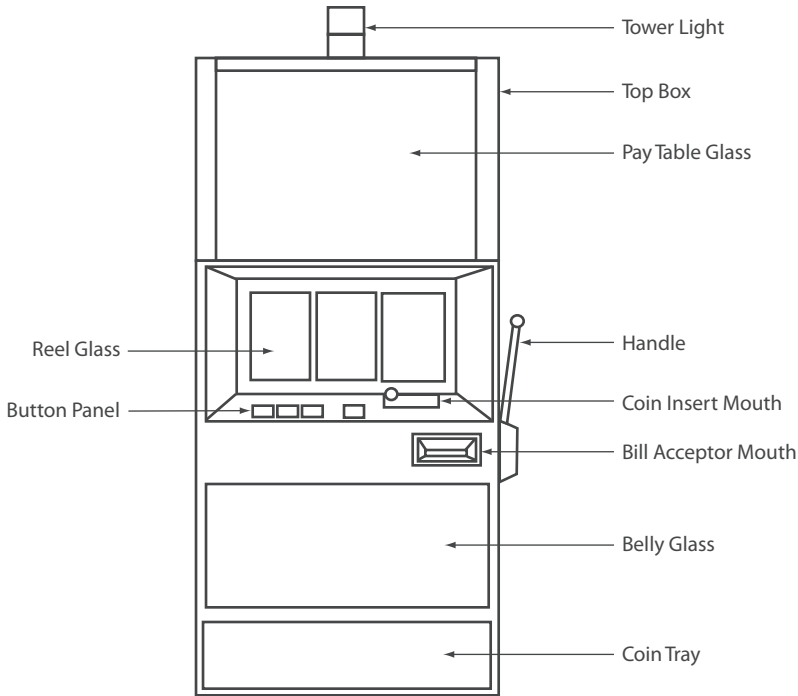
B I N G O				
14	25	34	52	68
1	24	38	51	69
4	26	Free	48	74
3	23	41	46	63
6	20	39	56	70

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*² 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

² 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:³

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 credits⁴ 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

³ 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.

⁴ 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.

<i>Number of Spins</i>	<i>Expected Deviation</i>
1,000	30–45%
10,000	10–15%
100,000	3–5%
1,000,000	1–1.5%
10,000,000	0.3–0.5%

The expected deviation represents the amount by which the actual payout percentage on a slot machine will differ from its theoretical payout percentage after 10,000,000 spins, within a certain confidence level. Normally, the industry standard assumes a 90 percent confidence level; however, this percent could vary based on jurisdiction. For example, assuming 1,000 spins and a theoretical payout percentage of 90 percent, the actual payout could be between 45 percent and 135 percent (assuming the high end of the expected deviation in the preceding table). For 10,000,000 spins, the actual payout percentage could be between 89.5 percent and 90.5 percent. Because every combination is random, there are no absolute guarantees of exact payout percentages.

Server Based Gaming

The previous description of slot machine operations addresses conventional slot machines that operate independently from other machines in the casino. Each machine determines the outcome of a wager using control programs contained on *erasable programmable read-only memory* installed in a secure manner within the device. Advances in server based gaming technology allow the slot machine to be interfaced with a system whereby the control programs within the slot machine can be modified to change the types of games being offered, denomination of the machines, and game themes. A slot machine that can be modified in this fashion is commonly known as a *system supported game*.

Another type of server based gaming technology allows the control programs to be stored on the computer system itself. When a wager is made, the determination of win or loss is made by the system with the outcome displayed on the slot machine. When configured in this manner, the slot machine simply becomes a display device with a ticket printer, currency acceptor drop box, and *bill validator*. Such system and display devices are collectively referred to as a *system based game*.

Although more sophisticated control programs, systems, and communication networks are required with server based gaming, the basic gaming revenue model for slot machine operations is still applicable.

Lotteries

State lotteries operate one or more of the following forms of lottery gaming:

- Lotto
- Instant games
- Video lottery terminals

Lotto tickets are sold by an agent with ticket issuance or validation terminals, which are interfaced with the lottery's central computer via communication

lines. Lotto tickets cost \$1 per play in most cases. A ticket can be purchased for several different types of games. Super lotto type games typically require the patron to select 6 numbers, and these drawings are held twice a week. The prize pools are typically pari-mutuel in nature, with the maximum prize increasing with every ticket sold. *Daily game* tickets can also be purchased, in which 3, 4, or 5 numbers must be selected, and the drawings take place once a day. *Keno lottery* tickets can also be purchased, and these games may be conducted as often as every 4–5 minutes. Super lotto ball drawing procedures are somewhat similar to procedures employed in a casino keno game in that balls are selected from a ball drawing device. The number of balls in the device varies depending on the game and state regulations. The drawing is performed in a public venue and is typically televised, and many times, will be monitored by an independent accountant. Many times, smaller payout games will use a computerized automated drawing device containing a random number generator. Winning tickets are validated by the agent, and the agent will make the smaller payments usually in amounts less than \$600. Larger winning tickets are paid by the central lottery office. Most states allow the winner of 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

(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.

activities that enable them to accomplish assigned responsibilities 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 ASC 842

This appendix is nonauthoritative and is included for informational purposes only. It is applicable to nongovernmental entities only. Governmental entities apply paragraphs .211–.271 of GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements (as amended), until GASB Statement No. 87, Leases, is adopted (see update 12-1 of this guide).

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

Transition

FASB ASC 842-10-65-1 describes the requirements for financial statement presentation when an entity first applies the guidance. Leases that exist at the application date and within the scope of FASB ASC 842 should be recognized and measured using the appropriate approach described in FASB ASC 842-10-65-1 items (a)–(ee), which address the following:

- Transition methods
 - Retrospective application to each prior reporting period presented in the financial statements with the cumulative effect of initial application recognized at the beginning of the earliest comparative period presented (subject to other transition requirements). Under this transition method, the application date should be the later of the beginning of the earliest period presented in the financial statements and the commencement date of the lease.
 - Retrospective application at the beginning of the period of adoption through a cumulative-effect adjustment (subject to other transition requirements). Under this transition method, the application date should be the beginning of the reporting period in which the entity first applies the guidance.
- Disclosure
 - Transition disclosures required by FASB ASC 250, *Accounting Changes and Error Corrections*
 - Use of practical expedient(s), if applicable
- Lessees
 - Leases previously classified under FASB ASC 840, *Leases*, as operating leases and capital leases
 - Build-to-suit lease arrangements
- Lessors
 - Leases previously classified under FASB ASC 840 as operating leases, direct financing or sales-type leases, and leveraged leases
 - Sale and leaseback transactions before the effective date

Transition disclosures are illustrated in paragraphs 243–254 of FASB ASC 842-10-55.

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 preceding 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
<p>Lessor should derecognize the underlying asset and recognize the following:</p> <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 	<p>Lessor should recognize all of the following:</p> <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
<p>Lessor should derecognize the underlying asset and recognize the following:</p> <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 	<p>Lessor should recognize all of the following:</p> <ul style="list-style-type: none"> a. Interest income on the net investment in the lease b. Certain variable lease payments c. Impairment

<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.

Subsequent Developments

ASU No. 2018-01

In January 2018, FASB issued ASU No. 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*. This ASU permits an entity to elect an optional transition practical expedient to not evaluate under FASB ASC 842 existing or expired land easements not previously accounted for as leases under FASB ASC 840.

Effective Date

The effective date of FASB ASU No. 2018-01 is in line with the guidance in ASU No. 2016-02.

ASU No. 2018-10

In July 2018, FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*. The amendments in this ASU affect narrow aspects of FASB ASC 842 and address the following sixteen specific areas for improvement:

1. Residual Value Guarantees
2. Rate Implicit in the Lease
3. Lessee Reassessment of Lease Classification
4. Lessor Reassessment of Lease Term and Purchase Option

5. Variable Lease Payments That Depend on an Index or a Rate
6. Investment Tax Credits
7. Lease Term and Purchase Option
8. Transition Guidance for Amounts Previously Recognized in Business Combinations
9. Certain Transition Adjustments
10. Transition Guidance for Leases Previously Classified as Capital Leases under Topic 840
11. Transition Guidance for Modifications to Leases Previously Classified as Direct Financing or Sales-Type Leases under Topic 840
12. Transition Guidance for Sale and Leaseback Transactions
13. Impairment of Net Investment in the Lease
14. Unguaranteed Residual Asset
15. Effect of Initial Direct Costs on Rate Implicit in the Lease
16. Failed Sale and Leaseback Transaction

Effective Date

For entities that have not early adopted FASB ASC 842, the effective date and transition requirements are the same as ASU No. 2016-02. For entities that early adopted FASB ASC 842, the amendments were effective upon issuance of the ASU.

ASU No. 2018-11

In July 2018, FASB issued ASU No. 2018-11, *Leases (Topic 842) Targeted Improvements*. The amendments in this ASU can be organized into the following two areas:

1. Transition — Comparative Reporting at Adoption
2. Separating Components of a Contract

Transition — Comparative Reporting at Adoption

The amendments to transition guidance related to comparative reporting at adoption apply to all entities with lease contracts that choose the additional transition method provided by this ASU.

This ASU amends FASB ASC 842-10-65-1 to permit an entity to elect an optional transition method to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.

This ASU also amends FASB ASC 842-10-65-1 related to the optional transition method for the following:

- Disclosure
- Lessees with leases previously classified under FASB ASC 840 as
 - Operating leases
 - Capital leases
 - Build-to-suit lease arrangements
- Lessors with leases previously classified under FASB ASC 840 as
 - Operating leases

- Direct financing leases
- Sales-type leases
- Sale and leaseback transactions before the effective date

Separating Components of a Contract

The amendments related to separating components of a contract apply only to lessors whose lease contracts qualify for the practical expedient provided by this ASU.

This ASU amends FASB ASC 842-10-15-42 to permit lessors to use a practical expedient, by class of underlying asset, to not separate nonlease components from the associated lease component and, instead, to account for those components as a single component if the nonlease components otherwise would be accounted for under FASB ASC 606 and both of the following conditions are met: (1) The timing and pattern of transfer of the nonlease component(s) and associated lease component are the same, and (2) the lease component, if accounted for separately, would be classified as an operating lease.

This ASU makes related amendments to FASB ASC 842 that affect the implementation guidance and illustrations in the subtopic "Overall" and the disclosure requirements in the subtopic "Lessors."

Effective Date

The effective dates are as follows:

- For entities that have not adopted FASB ASC 842 before the issuance of this ASU, the effective date and transition requirements are the same as the those in ASU No. 2016-02. Amendments in ASU No. 2016-02 are not yet effective but can be early adopted.
- For entities that have adopted FASB ASC 842 before the issuance of this ASU, the election and application of the practical expedient is specified in the ASU.

All entities electing the practical expedient should apply the guidance by class of underlying asset to all existing lease transactions that qualify for the expedient at the date elected.

Appendix J

Revenue Recognition Implementation Issues

Note: See appendix B, "The New Revenue Recognition Standard: FASB ASC 606," of this guide for a general summary of the revenue recognition guidance.

This appendix is nonauthoritative and is included for informational purposes only. Note that FASB Accounting Standards Codification 606, Revenue from Contracts with Customers, does not apply to governmental entities.

Introduction

The content in this appendix presents chapter 6, "Gaming Entities," of the AICPA Audit and Accounting Guide *Revenue Recognition*. That chapter contains the implementation issues related to gaming entities that have been finalized as of the production date of this guide.

Notice to Readers

This chapter presents accounting implementation issues developed to assist management of gaming entities in applying FASB *Accounting Standards Codification*® (ASC) 606, *Revenue from Contracts with Customers*, and related interpretations from the FASB/IASB Joint Transition Resource Group for Revenue Recognition (TRG).

The AICPA Gaming Entities Revenue Recognition Task Force identified and developed these accounting implementation issues, and the AICPA Revenue Recognition Working Group and AICPA Financial Reporting Executive Committee (FinREC) approved them. They are a source of nonauthoritative accounting guidance for nongovernmental entities.

The accounting implementation issues have been organized within this chapter as follows:

- In relation to the five-step model of FASB ASC 606, when applicable:
 - Step 1: "Identify the contract with a customer," starting at paragraph 6.1.01
 - Step 2: "Identify the performance obligations in the contract," starting at paragraph 6.2.01
 - Step 3: "Determine the transaction price," starting at paragraph 6.3.01
 - Step 4: "Allocate the transaction price to the performance obligations in the contract," starting at paragraph 6.4.01
 - Step 5: "Recognize revenue when (or as) the entity satisfies a performance obligation," starting at paragraph 6.5.01

- By revenue stream, starting at paragraph 6.6.01
- As other related topics, starting at paragraph 6.7.01

The following table outlines the accounting implementation issues discussed in this chapter:

<i>Issue Description</i>	<i>Paragraph Reference</i>
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 Step 2: Identify the performance obligations in the contract	6.2.01–6.2.18
Definitions: the terms <i>win</i> and <i>gross gaming revenue</i> Revenue streams	6.6.01–6.6.08
Loyalty credits and other discretionary incentives (excluding status benefits) Revenue streams	6.6.09–6.6.50
Accounting for loyalty points redeemed with third parties Revenue streams	6.6.51–6.6.62
Accounting for loyalty co-branding arrangements Revenue streams	6.6.63–6.6.97
Accounting for management contract revenues, including costs reimbursed by managed properties Revenue streams	6.6.98–6.6.155
Accounting for jackpot insurance premiums and recoveries Other related topics	6.7.01–6.7.12
Accounting for gaming chips and tokens Other related topics	6.7.13–6.7.15
Net gaming revenue Other related topics	6.7.16
Gaming operator's accounting for base progressive and incremental progressive jackpot amounts Other related topics	6.7.17–6.7.23
Promotional allowances Other related topics	6.7.24–6.7.25
Participation and Similar Arrangements Other related topics	6.7.26–6.7.37
Income statement presentation of wide area progressive operators' fees received from gaming entities Other related topics	6.7.38–6.7.68
Recognition of the WAP operator's liability for base progressive and incremental progressive jackpot amounts Other related topics	6.7.69–6.7.74

<i>Issue Description</i>	<i>Paragraph Reference</i>
Accounting for racetrack fees Other related topics	6.7.75–6.7.106
Disclosures—contracts with customers Other related topics	6.7.107–6.7.130
Gaming entity's costs to obtain a management contract Other related topics	6.7.131–6.7.142

Application of the Five-Step Model of FASB ASC 606

Step 2: Identify the Performance Obligations in the Contract

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

This Accounting Implementation Issue Is Relevant to Step 2: "Identify the Performance Obligations in the Contract," of FASB ASC 606.

Background

6.2.01 Many entities have incentive affinity programs that enable customers to achieve a tier status based on their loyalty or their repeat purchases of goods and service in the ordinary course of business. Such tier status may also be provided to a customer on a trial basis based on the expectation of the customer achieving the status at some defined point in the future. The tier status then entitles the customer to access specific goods and services at a discount in the future. In other cases, although the tier status does not entitle the customer to specific discounted goods and services, the entity may have created a reasonable expectation that the customer will receive discounted goods or services. In many cases, the objective of tier status programs is to incentivize high-spending customers through the offer of discounts on future purchases commensurate with each customer's spending level. Affinity programs with tier status require careful evaluation because some programs may have elements similar to point loyalty programs, which are generally considered to reflect material rights that would be separate performance obligations. In other circumstances, such programs are designed to provide marketing incentives on future revenue transactions, which may not be separate performance obligations.

6.2.02 For purposes of this section, the following assumptions and definitions are used:

- a. *Tier status* is defined as a level (or sub-level) within an affinity program sponsored by an entity that generally accumulates or vests as a result of the customer attaining a defined level predominantly from past revenue transactions (for instance, number or amount of prior purchases).
- b. *Status benefits* are an option to obtain future goods and services at a discount or at no additional cost provided to a customer that has been designated as having tier status.
- c. Affinity programs are structured to promote customer loyalty and concentration of spending; status benefits are generally provided

along with the purchase of a future product or service from the entity.

- d. Material benefits provided by affinity programs for which the member is not required to make a future purchase would generally follow basic affinity program accounting.
- e. *Appropriate past qualifying transactions* are transactions under the affinity program that earn tier status. Transactions may qualify as "appropriate past qualifying transactions" based on the number of transactions, the amounts of the transactions, or other similar types of measurements.

6.2.03 The issue is how an entity sponsoring a tier status program should apply the guidance in FASB ASC 606 to assess whether the status benefits give rise to a separate performance obligation (a material right) or whether they represent a marketing incentive related to future purchases.

FASB ASC 606 Guidance

6.2.04 When evaluating whether tier status gives rise to a separate performance obligation, sponsoring entities would need to consider the guidance in FASB ASC 606. Specifically, paragraphs 42–43 of FASB ASC 606-10-55 state the following:

If, in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services, and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

If a customer has the option to acquire an additional good or service at a price that would reflect the standalone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those cases, the entity has made a marketing offer that it should account for in accordance with the guidance in this Topic only when the customer exercises the option to purchase the additional goods or services.

6.2.05 Paragraph 11 of TRG Agenda Ref 54, *Considering Class of Customer When Evaluating Whether a Customer Option Gives Rise to a Material Right*, notes that paragraph BC386 of FASB Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*,¹ explains that the purpose of the guidance in paragraphs 42–43 of FASB ASC 606-10-55 is to distinguish between

¹ Paragraph BC386 and other paragraphs from the "Background Information and Basis for Conclusions" section of FASB Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, were not codified in FASB Accounting Standards Codification® (ASC); however, the AICPA Financial Reporting Executive Committee believes paragraph BC386 provides helpful guidance and, therefore, decided to incorporate it in this guide.

- a. an option that the customer pays for as part of an existing contract (that is, a customer pays in advance for future goods or services), and
- b. a marketing or promotional offer that the customer did not pay for and, although made at the time of entering into a contract, is not part of the contract (that is, an effort by an entity to obtain future contracts with a customer).

6.2.06 Paragraph 12 of TRG Agenda Ref 54 also explains, "Stated differently, the guidance in paragraphs 606-10-55-42 through 55-43 is intended to make clear that customer options that would exist independently of an existing contract with a customer do not constitute performance obligations in that existing contract."

6.2.07 If an entity determines that status benefits provide a customer with a material right that is accounted for as a performance obligation, an entity is required to allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis in accordance with the guidance in paragraphs 28-41 of FASB ASC 606-10-32. This would include allocating a portion of the transaction price of each accumulating purchase (such as an airline ticket or hotel stay) to the option.

6.2.08 The guidance in FASB ASC 606 specifies the accounting for an individual contract with a customer. Entities may use a portfolio approach as a practical expedient to account for contracts with customers as a group rather than individually if, as required in FASB ASC 606-10-10-4, the financial statement effects are not expected to materially differ from an individual contract approach.

Evaluation of Status Benefits

6.2.09 A sponsoring entity would view status benefits as an option that gives rise to a separate performance obligation if, as described in FASB ASC 606-10-55-42, that option (or benefits similar to status benefits) provides a material right to the customer that is not available to customers who have not achieved tier status through a defined level of past qualifying revenue transactions with the sponsoring entity. If that option (or benefits similar to status benefits) is made available only to customers who have achieved tier status through appropriate past qualifying revenue transactions with the sponsoring entity, this would be evidence that status benefits are solely related to the contracts for past revenue transactions and, therefore, should be assessed to determine whether they represent a material right.

6.2.10 A sponsoring entity would view the status benefits conveyed by tier status as a marketing incentive if those status benefits are conveyed by other means (that is, not exclusively related to the level of prior revenue transactions with the sponsoring entity) as part of its customary business practices, such that the discounts provided through status benefits are typically available to the class of customer, independent of an individual customer's past revenue transactions with the sponsoring entity. A sponsoring entity will provide such benefits to attract new customers and incentivize future sales, similar to other marketing incentives. For example, many entities give away tier status designation based on an expectation that the customer will spend in the future at tier status levels and, as such, will eventually justify the discounts provided. In these situations, the tier status is awarded for a period of time with little or no history of spending at the sponsoring entity, based on an expectation that the

customer will spend at the specified tier status level in the future. This is sometimes done to identify and attract customers who have historically spent at high levels with other entities or other high-value potential customers who might, for example, be identified based on job title, profession, or employer. In substance, the sponsoring entity may view its granting of tier status as a means of customer recruitment or retention to entice high-spending customers to spend and become or remain loyal customers of that entity. Entities view the class of customer as customers willing to spend at certain levels, regardless of whether the customer is currently a customer of the entity.

6.2.11 Because tier status is generally achieved through an accumulation of the customer's past revenue transactions over a period of time, FinREC believes the assessment of whether tier status represents a material right should be performed by evaluating the aggregate transactions of the customer over a specified period of time, versus on an individual transaction basis, such as the purchase of an individual airline ticket, hotel room, or other transaction. Any assessment would be based on specific facts and circumstances and would require significant judgment.

6.2.12 From here through paragraph 6.2.17, this chapter assumes that any status benefits being assessed are material (based on both qualitative and quantitative factors) and that tier status and associated status benefits are not obtained through a nominal level of past revenue transactions.

6.2.13 In order to determine whether tier status is a material right (as discussed in paragraph 6.2.09) or a marketing incentive (as discussed in paragraph 6.2.10), it is necessary to analyze the substance of the arrangement. FinREC believes that indicators that discounts on goods and services conveyed as a result of attaining tier status are available to a class of customers irrespective of their past qualifying revenue transactions with the sponsoring entity (and that, therefore, the tier status would not give rise to a separate performance obligation and would be considered a marketing incentive) include, but are not limited to, the following:

- a. The entity has a business practice of providing tier status (or similar status benefits) to customers who have not entered into the appropriate level of past qualifying revenue transactions with the entity.
- b. Tier status is provided for a period of time based only on the anticipation by the entity that the customer being provided status benefits will enter into future revenue transactions with the sponsoring entity commensurate with that of an individual earning tier status through past qualifying revenue transactions, and the entity has a business practice of providing tier status or equivalent benefits on a temporary basis as a result of the expectation that a customer will achieve a certain future spending level.
- c. Tier status can be earned or accrued by activity with unrelated companies that have a marketing affiliation agreement with the entity sponsoring the affinity program (marketing partners), which results in limited or no consideration to the sponsor as compared to actual qualifying revenue transactions with the sponsor.

6.2.14 FinREC believes the existence of one or more of the following factors in such a program could indicate that the tier status or certain of the benefits received by tier status customers are a separate performance obligation:

- a. The program sponsor sells (directly or indirectly through marketing partner arrangements) tier status for cash (excluding immaterial "top-off" payments made by customers to retain their previous status when they fall just short of the defined target).
- b. Customers who receive matched status must achieve a higher level of qualifying activity in the specified period than customers who earned equivalent status.
- c. The discount provided on future goods and services combined with the anticipated future purchases by a customer results in a loss on that customer's anticipated future revenue transactions.
- d. The option is transferable by the customer to unaffiliated members, effectively preventing the program sponsor from determining the class of customer being marketed to.

6.2.15 The factors in paragraphs 6.2.13–6.2.14 provide entities additional guidance in determining whether the principles in paragraphs 6.2.09–6.2.10 have been met and do not override the principles in those paragraphs. These factors are provided to assist in the analysis of whether such goods or services are made available to customers or classes of customers at a similar discount independent of the contracts for past revenue transactions. These factors should not be viewed in isolation, do not constitute a separate or additional evaluation, and should not be considered a checklist of criteria to be met in all scenarios. Considering one or more of the indicators will often be helpful in determining whether the entity typically makes such goods or services available to customers or classes of customers at a similar discount independent of the contracts for past revenue transactions. Depending on the facts and circumstances, the indicators may be more or less relevant to the assessment of whether the entity typically makes such goods or services available to customers or classes of customers at a similar discount independent of the contracts for past revenue transactions. Additionally, one or more of the indicators may be more persuasive to the assessment than the other indicators. These indicators are intended to provide guidance to assist the sponsoring entity in evaluating whether the substance of the arrangement is that of a reward for past purchases or a marketing incentive provided to a class of customers who are expected to spend at future levels that would enable them to attain tier status through such past qualifying transactions.

6.2.16 FinREC believes that an entity's assessment of tier status should generally be performed at each tier level. The benefits available at each tier level are usually different, and sponsoring entities may match demonstrated tier status earned through a competitor or partner at certain levels but not at others. For example, a sponsoring entity may match tier status that a customer has with a competitor at all levels except the very highest level, in which case the sponsoring entity may grant the second highest tier status rather than the top tier. Because each affinity program is unique, it may be necessary for the sponsoring entity to make its assessment at each individual tier level if the criteria described in paragraphs 6.2.13–6.2.14 are not applicable to all tier levels.

6.2.17 As a result of an assessment of the preceding principles and indicators, an entity may determine that discounted goods or services available to an individual with tier status are typically made available to a particular class of customer. Such an assessment will necessarily require judgment based on facts and circumstances. If the entity reaches the conclusion that it makes

status benefits (or the underlying discounted goods or services) available to customers or classes of customers who have not earned such benefits as a result of past qualifying revenue transactions with the sponsoring entity, then FinREC believes tier status would not give rise to a separate performance obligation.

6.2.18 The following gaming affinity program example is meant to be illustrative of the actual determination of whether a tier status program is a material right or a marketing incentive should be based on the facts and circumstances of an entity's specific situation. See example 10-2-1 in chapter 10, "Airlines," for an illustrative example of the evaluation of an airline affinity program.

Example 6-2-1

Background—Gaming Industry

The following background information reflects common industry practices with respect to customer analysis and complimentary services.

VVIP customers (VIPs with very high spending power) are a very small subset of customers. These customers are considered "highly rated" and are generally known by each gaming entity—that is, they represent a distinctive group of "high rollers" that desire to gamble at very high limits. Such VVIP customers generally receive complimentary rooms, food and beverages, entertainment, lounge access, and other perks ("complimentaries") regardless of the gaming entity they are currently visiting. Such customers rarely pay for lodging and other goods and services while at a gaming entity's property due to their high value and willingness to put large amounts at risk. The complimentary services will be more valuable than basic complimentary services (for instance, a suite versus a room, exclusive tickets versus general admission, free air travel on a company-provided plane, and so on). Such VVIP customers are generally considered to be (and are tracked by gaming entities as) a distinct class of customer and are usually provided the following types of additional goods and services at no additional cost:

- Gaming entities often have charter air service or private jet service available to accommodate the VVIPs' travel to and from the casino.
- Visits by VVIPs are often planned by a casino host and the host will often require a certain amount of money be placed "at risk."
- Such VVIPs will be provided exclusive areas in which to gamble, separate from all other customers.
- If a VVIP is not in a gaming entity's existing affinity program, the VVIP will generally be granted immediate status in that program, consistent with the status of other similarly rated players.

Gaming entities will generally subdivide their remaining customers as follows:

- *VIP customers.* Those customers (again, regardless of the gaming entity at which they have attained a player rating) who are willing to gamble at higher limits than a basic customer, and who often achieve their ratings through more frequent visits to a property than a basic customer. Gaming entities routinely track such play and generally will assign a value to such customers, often referred to as "customer worth." These customers may have qualities of high frequency or higher volume players (or both) with higher "worth" to a gaming entity. VIPs will generally receive complimentary services upon each visit if the individual is known to be a rated

player (again regardless of the gaming entity at which the VIP has attained a player rating and regardless of whether the VIP has a particular tier status at the property), but such complimentaries are generally lower value in nature than the complimentaries provided to VVIPs. Rather, such complimentaries are limited to normal rooms, meals, and entertainment offerings.

- *Basic customers.* This category represents all remaining customers, who, depending upon a specific trip and the amount and duration of their play, may be provided a complimentary by a casino on a discretionary basis during such visit regardless of an achieved tier status level. These are the majority of customers.

If an individual not known to a casino is gambling at the level of a VVIP (which is generally very rare because these individuals are typically known across the industry) or VIP and requests complimentaries, they will often be provided such complimentaries, regardless of whether they are a part of the affinity program of the property at which they are currently gaming. Gaming entities will generally support a request to provide such complimentaries to keep the customer happy and gaming at their establishment.

Gaming entities will often provide complimentaries to incentivize additional customer visitation to their properties. Such incentives may be goods and services, such as free buffets, match play, and so on, depending on the amount placed at risk.

The complimentaries provided to all classes of customers noted previously (other than VVIPs) are generally of the same nature and type (the same restaurant, the same buffet, the same type of ticket).

"Discretionary" complimentaries may be provided to both affinity program members and non-affinity program members, but the complimentary is not associated with the affinity program. Gaming entities routinely provide a material amount of such discretionary complimentaries (both through mail and through observing customer play while at the casino) as a normal course of business.

The majority of customer gaming activity is unrated play (which means the customers are not members of the affinity program).

Gaming entities will often match the status of a rated player at another casino property, depending on their assessment of the customer's worth.

The following are common characteristics of gaming loyalty programs:

- Because gaming activity is primarily conducted through cash transactions or chips that were purchased by the gaming customer for cash, a gaming entity has limited mechanisms to understand customer behavior. As a result of this foundational factor, and to induce customer loyalty, most gaming entities have developed customer affinity programs to enable them to understand characteristics of customer play and develop targeted marketing programs.
- Points and tier credits are granted to the customer based on completed play. The earnings method depends on the type of game played, an approximation of the amount wagered, and the duration of play.
- Loyalty points are banked and accumulate, allowing a program member to redeem them for a number of different types of

incentives, which could include cash, complimentary, other goods or services, or free play.

- Tier credits, on the other hand, are not redeemable, but rather are used to determine progress toward tier status.
- Multiple tier status levels will exist with increasing amounts of qualifying activity required to attain each successive tier status. Entry level status is granted upon receipt by the gaming entity of appropriate information (name, email, physical address), enabling future marketing. With increased tier status, additional status benefits are provided, including room upgrades, discounts on goods and services, exclusive lounge access, fee waivers, complimentary check-ins, and in certain cases (generally reserved for the highest tier status), complimentary rooms.
- The vast majority of customers attaining tier status will be concentrated in the lower tier(s), which provide minimal discounts and significantly lower status benefits as compared to the top tier(s).

Background—Victory Casino

Victory Casino (Victory) is a gaming entity that sponsors an affinity program called Connected Rewards that is designed to award tier status levels based on prior play. This program contains five tiers, with the top tier being Chairman's Level. The following is a summary of tier status levels based on program materials disbursed to all program participants. Tier status is determined annually based on the preceding program year's activity.²

<i>Designated Status Level</i>	<i>Gaming Activity Level Required for Status Level</i>	<i>Status Benefits</i>
Tier One-Silver		Discounts on future goods and services
Tier One-Gold	\$100	Silver level benefits with larger discount percentages
Tier Three-Platinum	\$15,000	Gold level benefits with certain complimentary
Tier Four-Diamond	\$25,000	Platinum level benefits with ten percent great complimentary

² For these examples, gaming activity is either coin-in (money placed into a slot machine) or table drop (money placed at risk at a gaming table). Neither of these measures of activity represent the amount a customer loses (and thus revenue to the gaming entity); rather, they represent the amount put at risk. Casinos are generally unable to track every hand played at a gaming table and thus the method of assigning loyalty credits for table games is a function of amount placed at risk, average bet, the type of game being played, and the duration the customer gambles. As such, in these two gaming examples, "activity" is used synonymously with "revenue transaction" as used in paragraph 6.2.02a. This is due to typical gaming transactions with customers having the potential to generate no revenue or negative revenue to the gaming entity due to the inherent nature of gambling—that is, gambling involves games of chance in which there are three potential outcomes: (1) the gaming entity wins, resulting in revenue to the gaming entity; (2) the customer wins, resulting in negative revenue to the gaming entity; or (3) break-even, which has no impact on revenue.

<i>Designated Status Level</i>	<i>Gaming Activity Level Required for Status Level</i>	<i>Status Benefits</i>
Tier Five-Chairman's Level	\$100,000	Diamond level with larger complimentary plus annual \$10,000 Chairman's Award ^(*)
<p>* Chairman's Awards in this example are goods and services not otherwise sold or provided in the ordinary course of business by the gaming entity and generally have characteristics associated with earning the awards based on past play, similar to a point or loyalty program. An example of such a Chairman's Award may be an "experiential gift" to a customer, such as a vacation, Super Bowl tickets, or electronics merchandise that the gaming entity does not sell or otherwise provide in its normal operations.</p>		

In addition, Victory has the following basic fact pattern:

- The basic facts set forth earlier in the section "Background—Gaming Industry" are consistent with Victory's experience and customary business practices.
- The value of complimentary represents approximately 20 percent of total revenue for the previous year, and the value is expected to represent a similar percentage of revenue in the next year.
- Victory has determined that status benefits and complimentary granted as a customary business practice by Victory are substantially similar because the two categories of benefits (status benefits and complimentary) include free play and free or discounted lodging, entertainment, food, and beverages (all of a similar quality and nature), which represent substantially all (over 90 percent) of the benefits offered to both tier status members and non-tier status members.

With respect to complimentary provided to customers in the most recent fiscal year,

- 25 percent were earned by customers through redemption of loyalty points.
- 50 percent were earned through the achievement of tier status.
- 25 percent were provided on a discretionary basis, based on either coupon redemption or provision at the time gaming activity occurred (that is, outside the context of Connected Rewards). Of these complimentary, Victory estimates that approximately 70 percent are provided to VIP and basic customers.

All of the preceding background facts apply equally to examples 6-2-1A and 6-2-1B.

Example 6-2-1A—Tier Status Explicitly Entitles the Customer to Specific Economic Benefits

Evaluation of Chairman's Award

Because Victory offers similar benefits to all members of a tier status level, Victory believes that its evaluation of a contract with an individual status

customer would be reflective of whether its contracts with other similar status members include a material right. Therefore, Victory believes that it can use the practical expedient in FASB ASC 606-10-10-4 that permits an entity to apply FASB ASC 606 guidance to a portfolio of contracts or performance obligations (that is, it is not necessary for Victory to perform the evaluation on a contract-by-contract basis).

Victory assesses the principles in paragraphs 6.2.09–6.2.10 and concludes that the annual Chairman's Award provides a material benefit separately distinguishable from the other marketing incentives available at Chairman's Level tier status. Because Victory only provides the Chairman's Award to customers as a result of their achieving Chairman's Level tier status, and the Chairman's Award is not offered to any other customers in any other program, Victory concludes under paragraphs 6.2.09–6.2.10 that the Chairman's Award has characteristics similar to the accumulation of points in an affinity program and therefore gives rise to a performance obligation. Victory's assessment of the indicators in paragraphs 6.2.13–6.2.14 does not provide any indication that Victory makes benefits similar to the Chairman's Award available to customers not achieving Chairman's Level tier status through past qualifying activity. Therefore, Victory must allocate a portion of consideration received from the customers expected to attain the Chairman's Level status to the separate performance obligation (the material right), reducing current revenue. Victory updates its estimate periodically to assess whether the actual number of program members expected to attain Chairman's Level status will differ from its historical 5 percent achievement rate.

Victory's assessment of all other status benefits is analyzed separately in example 6-2-1B.

Example 6-2-1B—Gaming Entity (Victory) Provides All Customers Achieving a Certain Tier Status Level With Specific Benefits, Including Discounts on Future Goods and Services

Victory's assessment of its classes of customers is as follows:

- VVIPs represent approximately 5 percent of total customers and are often Chairman's Level participants in Connected Rewards.
- VIPs represent approximately 10 percent of total customers (whether rated or unrated by Victory) and, if they are participants in the Connected Rewards program, are often Platinum or Diamond tier status level, or game at a level consistent with those levels.
- Basic customers represent the remaining 85 percent of customers and would generally game at a level consistent with that of no more than Gold tier status level.

As noted in background information about Victory, Victory's customary business practice includes the granting of complimentaries on a broad basis, and therefore it determines that it must assess whether the status benefits granted to each class of customer is made available to other customers who have not earned tier status through appropriate past qualifying activities and whether complimentaries are evidence of such activity.

Victory first assesses whether it provides basic and VIP customers benefits outside of Connected Rewards that are similar to the status benefits that these customer classes may receive as a result of their participation in Connected Rewards.

Victory's assessment with respect to the indicators in paragraph 6.2.13 includes the following additional facts:

- As noted previously, the majority of discretionary complimentarys granted as a customary business practice by Victory are provided to basic and VIP customers, and the amount of such complimentarys provided to these classes of customers without regard to tier status is similar to the amount of complimentarys provided to customers in these classes who have attained tier status (including discretionary complimentarys and other status benefits they are entitled to given their tier status).
- As noted previously, a VIP customer is often known to gaming entities and will generally be provided benefits similar to status benefits at each property visit regardless of the VIP having attained tier status at that particular gaming entity.

Because the benefits are provided irrespective of past qualifying activity and are provided in similar amounts and to the same class of customers as status benefits, Victory concludes that it has a customary business practice of providing tier status (or similar status benefits) to customers who have not entered into the appropriate level of past qualifying revenue transactions.

Victory then assesses the status benefits conveyed through the Chairman's Level in Connected Rewards (other than the Chairman's Award assessed in example 6-2-1A). Because the VVIP class of customer is determined based on their high customer worth and tendency to place large amounts at risk, Victory concludes that such customers are substantially similar to Chairman's Level participants in that VVIP customers and Chairman's Level participants both tend to wager significant amounts.

Next, Victory assesses its customary business practices with respect to such VVIP customers. Victory notes the following factors are present in Connected Rewards:

- It grants tier status to VVIP customers in advance of them visiting a property for the first time.
- Generally, any VVIP known to Victory who makes a property visit will be provided complimentarys consistent with the benefits provided to a Chairman's Level member (regardless of their participation in Connected Rewards).
- Victory has a history of matching status for VVIP customers that are known to it.
- Due to the customer worth of a VVIP customer, the value of benefits anticipated to be provided to a specific VVIP customer are not expected to result in a loss on future transactions. (Victory has a separate mathematical model indicating that each VVIP trip is worth substantially more than the combined cost of goods and services provided, inclusive of the status benefits).
- The VVIP customer is not able to transfer his or her benefits to another unaffiliated person.

Based upon the foregoing, Victory determines through its assessment of the indicators in paragraphs 6.2.13–6.2.14 that the benefits conveyed by tier status exist outside of contracts for past revenue transactions and, thus, are not a material right. Victory specifically identifies that the indicators in paragraphs

6.2.13a–6.2.13b are present because it conveys tier status or similar benefits (either for a normal program period or for a specific customer visit) to customers who have not entered into past qualifying transactions. In addition, Victory does not identify any criteria in paragraph 6.2.14 as being present. Therefore, Victory concludes that status benefits are a marketing incentive.

Revenue Streams

Definitions: The Terms *Win* and *Gross Gaming Revenue*

This Accounting Implementation Issue Is Relevant for Application of FASB ASC 606 to Gaming Transactions.

6.6.01 Gaming entities provide entertainment services to customers in the form of property themes, various gaming offerings, lodging offerings, food and beverage offerings and many other forms of entertainment offerings, which may include water or light shows, art collections, musical performances and other similar items. Some of these entertainment offerings may be provided free with no further obligation by the customer, may be offered as part of a package or loyalty program, or may be provided in exchange for consideration on the part of the customer.³ A focus of the overall entertainment offered by the gaming entity are the various games of chance that a customer may participate in by putting at risk their money through wagering transactions. Gaming (wagering) transactions represent an agreement between the customer and the gaming entity whereby, based on the outcome of an event (such as the results of accumulated cards in a hand of play for a table game or the outcome of the individual wager on a slot machine game) either (1) the gaming entity retains the amount wagered by the customer, or (2) the wager is returned to the customer along with an additional amount effectively representing the gaming entity's side of the wager in the agreement. Accordingly, a single wagering transaction either results in a net inflow of consideration to the gaming entity or a net outflow of amounts to the customer. The customer understands that in exchange for the entertainment offerings provided by the gaming entity, the statistical odds of the various games offered to customers favor the gaming entity. The customer may seek to improve the odds to his favor through the game type played, the specific bet made in a wager, statistically sound strategies for playing certain games and through incentives offered to the specific customer by the gaming entity. However, the gaming entity makes business decisions to ensure the odds of the conduct of the game remain in the gaming entity's favor.

6.6.02 As part of a gaming entity's business model, some wagers by customers will result in a loss to the entity, whereas others will result in a gain to the entity. The transaction price in a wagering transaction, as described in FASB ASC 606-10-32-2 and 606-10-32-3, is the amount of consideration to which a gaming entity expects to be entitled in exchange for transferring promised goods or services to a customer. FASB ASC 606-10-32-25 and 606-10-32-26 describes the treatment for consideration payable to a customer and states "[i]f the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the

³ This section does not address those contracts where a customer's wagering includes receipt of other goods and services.

transaction price."⁴ Because the contract with the customer is usually defined as a single wager in which both parties must perform (either the house must provide compensation to the customer, or the customer must forfeit their wager to the house), the consideration or transaction price to which the gaming entity is entitled may be positive, zero or negative. However, given the odds are in favor of the gaming entity, the size of individual wagers, the volume of wagers that occur in a day, month and year at a casino and the types of wagers allowed, the accumulation of such transaction amounts results in positive net revenue for the entity.

6.6.03 FASB ASC 606 does not address the presentation of revenue in a contract resulting in a negative transaction price. FinREC believes that given the gaming industry's specific facts and circumstances (including the business model and the nature of the contracts entered into by gaming entities) it is appropriate for gaming entities to present this negative transaction price as a component of net revenue. Accordingly, FinREC believes revenue recognized and reported for gaming transactions is the difference between gaming wins and losses, not the total amount wagered.⁵ This is commonly referred to as "win" or "gross gaming revenue".

General Considerations and Facts Applicable to all Gaming Transaction Examples

6.6.04 Practically speaking, most gaming customers place multiple wagers during each visit to the casino and will win some wagers and lose other wagers resulting in a net win or loss for the day by the customer. Revenue is determined daily at the individual table or device level representing a portfolio of customer transactions for the day. To facilitate the illustrative examples, the analysis of the examples that follow describes the elements of an individual wager rather than a portfolio of customer transactions for the day. See additional considerations around the contract under the discussions in the examples of the following transaction price. As explained in paragraph 6.6.03, the transaction price for each wager contract is deemed to be the net win or net loss of the wager by the customer.

6.6.05 The business model and practices for a gaming entity to conduct its operations acknowledges and assumes that based on statistical probabilities some customers will end their visit as a net winner and others will end their visit as a net loser for the timeframe in which the entity captures and

⁴ The consideration paid or payable to a customer in a wagering transaction is not made to the customer in exchange for a distinct good or service, as the customer is not providing any goods or services to the gaming entity. FASB ASC 606-10-32-25 describes how that consideration would be accounted for as a reduction of revenue.

⁵ FASB ASC 924-815-25-1 states the following:

Wagering contracts placed by bettors for which the odds of winning at the time the bets are placed with a casino are known or knowable (for example, certain sports and race wagers) are fixed-odds wagering contracts. The issuer of those contracts shall not account for such contracts under the guidance in Topic 815 on derivatives and hedging. Rather, those contracts are revenue transactions for a casino and shall be recognized in accordance with Topic 606 on revenue from contracts with customers.

BC41 of FASB ASU No. 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, states the following:

The amendments in this update clarify that fixed-odds wagering contracts for entities within the scope of Topic 924, are not within the scope of the derivatives guidance in Topic 815. Rather, those contracts should be accounted for in accordance with Topic 606. The treatment of fixed-odds wagering contracts as revenue transactions is consistent with the current guidance in Subtopic 924-605, Entertainment—Casinos—Revenue Recognition.

records gaming revenue (generally daily). Also, based on the statistical odds in favor of the gaming entity, the results for the entity over a broad base of transactions is expected to be a net positive gaming revenue to the entity. The gaming entity believes it is providing entertainment to its customers, and in order to appropriately attract and entertain customers, the gaming experience for a typical customer consists of numerous small dollar bets made frequently over the customer's designated time frame for being entertained. The net results of all customer gaming transactions in a day are accumulated at the individual table or device and physically controlled through individual locked boxes at the table or device. The contents of such locked boxes are counted daily and a determination of net win or loss by table or device is determined.

6.6.06 This combining of individual bets at a table or device as noted previously is allowed per FASB ASC 606-10-10-4, which indicates that "as a practical expedient, an entity may apply this guidance to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts (or performance obligations) within that portfolio."

6.6.07 The following examples are meant to be illustrative and consist of simple gaming transactions with no complexities such as available loyalty programs, progressive jackpots, wide area progressive jackpots, discounts on markers, issuance of markers, or other items. These complexities are addressed in separate subsequent implementation issue papers and by their nature encompass the combining of individual betting transactions with the same customer occurring at or near the same time.

6.6.08 The examples given assume the customer enters into a single transaction with the gaming entity for illustrative purposes only. In practice, most customers choose to enter into multiple gaming transactions with the gaming entity and such transactions are deemed to have "a single commercial objective." Although FASB ASC 606-10-25-9 provides guidance for when an entity shall combine two or more contracts entered into at or near the same time with the same customer, the focus of this paper is on the transaction price the entity expects to be entitled in exchange for transferring the promised goods or services (entertainment value) to a single customer.

Example 6-6-1—Table Games Transaction

Description: A customer sits down at a Blackjack table to play. The customer places a twenty-dollar bill on the table, which the dealer exchanges for twenty \$1 gaming chips.⁶ The customer places five \$1 gaming chips as a wager for a hand of Blackjack. The dealer deals the initial cards for the game associated with the customer's wager, the customer makes decisions around whether to hold on to their existing cards or to receive additional cards. The hand is completed through the individual customers' decisions at the table as well as the dealer's required play for the house hand of Blackjack. As a result of this hand of play, the customer wins and receives five \$1 chips in addition to his or her

⁶ Gaming chips are used to facilitate gaming transactions within a casino and represent a financial liability to customers. Such chips are not "legal tender" and there is no guarantee that a customer will return the chips in exchange for currency, which results in some dollar amount of chips which will never be redeemed (commonly called "breakage") over time. Breakage related to outstanding chip liabilities is separately considered in a separate issue paper by the task force under the revenue recognition standard and accounting guidance in determining the timing, value and recognition of such amounts.

initial bet of five \$1 chips. The customer now has twenty-five \$1 chips, which can either be redeemed at the cage for currency or used in other gaming transactions.

The customer chooses to enter into a second transaction at the table by placing 10 \$1 gaming chips as a wager for a new hand of Blackjack. The dealer deals the initial cards for the game associated with the customer's wager, the customer makes decisions around whether to hold on to their existing cards or to receive additional cards. The hand is completed through the individual customers' decisions at the table as well as the dealer's required play for the house hand of Blackjack. As a result of this hand of play, the customer loses and forfeits the 10 \$1 chips wagered to the dealer's table inventory resulting in a win to the gaming entity. The customer now has 15 \$1 chips, which can either be redeemed at the cage for currency or used in other gaming transactions.

Step 1: Identify the Contract With a Customer

The customer and the gaming entity have entered into two separate transactions under informal or implied contracts. In the first transaction, the customer places a wager for \$5 in value of chips to play a hand of Blackjack. In the second transaction, the customer places a wager for \$10 in value of chips to play a hand of Blackjack. The customer understands that if they receive a losing hand, the five chips in the first instance (10 chips in the second instance) will be forfeited to the dealer's table inventory. If the customer receives a winning hand, the customer will receive back his or her initial wager plus an additional five \$1 chips in the first instance (10 \$1 chips in the second instance.)

By the customer placing the wager and the gaming entity accepting the wager both parties have approved the transaction. The rights of the parties and the payment terms are established based on past or general business practices, established rules of the game, and regulation. The contract is deemed to have commercial substance. As the gaming entity has previously collected the "consideration to which it will be entitled" through the exchange of currency for chips there is no additional consideration required regarding probability of collection.⁷

Step 2: Identify the Performance Obligations in the Contract

The performance obligation in this example is distinct. With respect to the \$5 wager (and separately the \$10 wager) of chips at the Blackjack table, the gaming entity has an obligation to honor the outcome of the hand of Blackjack dealt at the table and to payout an amount equal to the stated odds at the table (including the return of the initial wager) if the customer receives a winning hand. These elements to the obligation (honoring the outcome of the hand of play and making the appropriate payout) of the gaming entity are not separable and are therefore considered one performance obligation.

⁷ As noted, the example given contemplates that the customer exchanges currency for chips. In some cases, a customer may be granted credit by the gaming entity and given chips as a loan to the customer for use in play. The granting of credit in the transaction would not change the analysis and is not expected to result in different accounting, however, the gaming entity may want to consider the criteria in FASB ASC 606-10-25-1e, which states "It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectibility of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see FASB ASC 606-10-32-7)."

*Step 3: Determine the Transaction Price*⁸

Unlike a typical sales transaction where the customer pays money and receives in return goods or services, in a typical gaming transaction the customer and the gaming entity are wagering against each other. One way to look at it is that both the customer and the gaming entity have put down a wager with the winner taking all based on the outcome of the Blackjack hands. For a single wager, the ultimate transaction price is the net win or loss on a hand of play. This would be consistent with FASB ASC 606-10-32-3, which states that "When determining the transaction price, an entity shall consider the effects of ... consideration payable to a customer."

The gaming entity expects to realize a net win (or net consideration) from the aggregation of all the individual gaming transactions with a customer over the relationship based on statistical probabilities as a result of the design of the individual games, which favor the gaming entity over the individual customer. This is consistent with FASB ASC 606-10-32-2, which states "the transaction price is the amount of consideration to which an entity expects to be entitled"

Accordingly, due to the periodic capturing of daily concluded transactions, as shown in this example of single Blackjack wagers to a customer for a day, the transaction price that the gaming entity will record can either be negative or positive and represents the net win or loss from the transactions with that customer.

*Step 4: Allocate the Transaction Price to Performance Obligations*⁹

In the example, there is only one performance obligation to the gaming entity (the conduct of the game and the obligation to make good on the outcome of the bet). Accordingly, for this example no allocation is made.

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

For the Blackjack transactions mentioned previously, the performance obligation was satisfied upon the outcome of the hand of cards dealt. As the outcome of the transactions occurred within a few minutes of the placement of the bet by the customer, the revenue (or transaction price) for the day is immediately determined and because no further performance obligations exist for the gaming entity, revenue (net win or net loss) would be recognized at that time.¹⁰ Note that the gaming entity typically recognizes revenue (net win or loss) based on the gaming day of operation. The resulting accounting by the gaming entity of accounting for a day's transactions is consistent with the previous discussion around the transaction price and results in the same accounting as if the

⁸ As noted in footnote 7 there can be other more complex arrangements than described in this specific example. Those potential additional elements to the transaction (such as loyalty programs, promotions, discounts or concessions on markers) are considered in separate subsequent implementation issue papers and not addressed in this example.

⁹ See footnote 8.

¹⁰ In order to facilitate the efficient and optimal gaming experience to the gaming entity and its customers, individual betting transactions at table games are typically not separately recorded and later identified. Accordingly, the components that determine net win or loss to the gaming entity for the day at an individual table game are accumulated within a secured lock box at the table. Daily, the lock box is removed and its contents separated and counted and a determination of the net win or loss at the table is made and recorded for the day. This accounting is a form of the portfolio approach noted in FASB ASC 606-10-10-4.

gaming entity had accounted for each wager separately because negative revenue with a customer over the relationship timeframe is expected to be infrequent or rare.

For the first transaction, the gaming entity effectively records a loss of \$5 to gaming revenues. In the second transaction, the gaming entity effectively records a win of \$10 to gaming revenues. Assuming no other transactions occurred for the day, the gaming entity would reflect a net win of \$5 as gaming revenue for the day.

Example 6-6-2—Slot Machine Transactions

Example 6-6-2 is similar to the table games transaction in example 6-6-1 except that (1) instead of the customer receiving chips in exchange for the cash presented, the customer receives credits (with a dollar value) in exchange for the cash inserted into the slot machine, which can be used in a wager on the slot machine or cashed out in the form of a "ticket-out" that is redeemable for cash in a kiosk machine or the casino cage, and (2) the slot machine game is designed to function and determine the outcome of the bet without the intervention of a person other than the customer making decisions around their bet and the options given in the game. All other elements of the transaction would align with the analysis performed in example 6-6-1. Accordingly, similar to table games transactions, individual slot machine hands of play would result in either a net win or a net loss to the gaming entity. Similarly, the transaction price would be the entity's net win or loss from the transactions with that customer.

Example 6-6-3—Sports Betting Transactions

Sports betting transactions function similar to bets in example 6-6-1 and 6-6-2 however, many such bets are made in advance of the event that will determine the outcome of the wager. The customer places their bet in the custody of the gaming entity until the event occurs and the result of the event is determined, which may be at some date in the future other than the day the bet is made by the customer. The analysis of this transaction would be the same as in example 6-6-1 except that in step 5 the revenue (net win or net loss) is deferred and will not be recognized by the gaming entity until the performance obligation is satisfied,¹¹ which would correspond to the occurrence of the event to which the betting transaction relates. Thus, a bet made in November on the outcome of the Super Bowl would be treated as a contract liability until the outcome of the Super Bowl occurs in the following February, at which time recognition of the net win or net loss will be recorded.

¹¹ FASB ASC 606-10-05-4e indicates the following core principle related to the satisfaction of a performance obligation.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation—An entity recognizes revenue when (or as) it 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). The amount of revenue recognized is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For performance obligations satisfied over time, an entity recognizes revenue over time by selecting an appropriate method for measuring the entity's progress toward complete satisfaction of that performance obligation. (See paragraphs 23–30 of FASB ASC 606-10-25.)

Consistent with this core principle the gaming entities performance obligation is not satisfied until the event to which the betting transaction relates occurs and an outcome has been determined.

Loyalty Credits and Other Discretionary Incentives (Excluding Status Benefits)

This Accounting Implementation Issue Is Relevant for Application of FASB ASC 606 to Nondiscretionary Incentives Issued in Conjunction With Gaming and Nongaming Activity

6.6.09 A casino customer is a member of that casino operator's customer loyalty program. The casino operator's customer loyalty program grants points to the customer based upon play that has been completed (usually contemporaneous with such play). Once earned, such points can be redeemed by the customer for a number of different types of incentives which could include free play, cash, complimentaries, or other goods or services. The terms *discretionary* and *nondiscretionary* are defined in accordance with an entity's business practices. Accordingly, if such practice becomes customary (for example, the casino provides these incentives to specific customers and in turn the customer now understands or has a reasonable expectation of specific benefits from the entity) such practices would indicate that the program is nondiscretionary in nature.

6.6.10 Assume that a customer played \$10,000 on a slot machine, received \$9,300 in cash payouts, and earned 10,000 points entitling that customer to up to \$100 of incentives. For purposes of simplicity, there is no assumed expected breakage¹² in this example.

6.6.11 Gaming entities are generally able to understand individual customer characteristics of play depending upon the type of gaming activity. For instance, if a loyalty customer inserts his card into a slot machine, the gaming entity will be able to monitor and accumulate the volume of that customer's play and will be able to award loyalty points based upon that activity. For table games, if a loyalty customer presents his card at the table, the gaming entity will generally capture the duration of play and the cash amount exchanged for gaming chips and the amount cashed out at the completion of wagering activity. However, for table games, the amount of loyalty credits awarded to the customer is subject to more judgment, as it is based upon the casino's estimation of a customer's average wager in addition to the more objective criteria as to the amount at risk, duration of play and type of game. After such judgmental information is captured, the gaming entity generally will follow a pre-defined methodology for awarding loyalty points.

Five-Step Analysis

Identify the Contract With a Customer

6.6.12 See the analysis included in example 6-6-1, "Table Games Transaction," in paragraph 6.6.08.¹³

¹² Breakage (customers' unexercised rights) are addressed in paragraphs 46–49 of FASB ASC 606-10-55.

¹³ Note that consistent with the way casino gaming is conducted, the transaction price for gaming transactions can vary significantly and cannot be reasonably estimated on an individual transaction basis. The conclusions reached in "Definitions: The Terms *Win* and *Gross Gaming Revenue*" (paragraphs 6.6.01–6.6.08), acknowledge this. Within the context of the casino's contract with a gaming customer the casino is providing the customer with a "gaming experience" including the gaming facilities, the conduct of the games by qualified personnel, properly structured casino games and making good on any wagers won by the customer. Accordingly, though in the context of the discussion noted

(continued)

Identify the Performance Obligations in the Contract

6.6.13 FinREC believes the performance obligations in a slot machine wagering transaction in which the customer also earns loyalty credits are distinct as described by FASB ASC 606-10-25-19a because the customer can benefit from the outcome of the wager immediately upon the conclusion of the spinning of the slot machine reels and the customer is able to benefit in the future from the loyalty credits separate from the gaming transaction. FinREC also believes the criteria described by FASB ASC 606-10-25-19b have been met because, with respect to the \$10,000 wagered, the gaming entity has an obligation to honor the outcome of the wager if the customer wins and the customer will forfeit the wager if the customer does not win. In addition to the wager (which is the primary gaming performance obligation in this and all further examples), the nondiscretionary incentives available to the gaming customer as a result of the loyalty program (free play, cash, complimentaries, or other goods or services or loyalty credits that can be redeemed for those incentives) represent material rights that also would be performance obligations.

Free Play, Cash, Complimentaries, or Other Goods and Services and Loyalty Credits That Can Be Redeemed for Such Goods and Services (Collectively, Incentives)

6.6.14 Paragraphs 42–44 of FASB ASC 606-10-55 indicate that if a customer option under a contract (specifically including sales incentives and customer award credits or points) provides a customer with a material right it gives rise to a performance obligation to which an entity must allocate a portion of the transaction price. As explained in paragraph 12 of FASB/IASB TRG Agenda Ref 54 stated differently, the guidance in paragraphs 42–43 of FASB ASC 606-10-55 is intended to make clear that customer options that would exist independently of an existing contract with a customer do not constitute performance obligations in that existing contract."

6.6.15 Nondiscretionary loyalty programs have become a material part of gaming entity marketing activities and gaming entities believe their customers included in these loyalty programs alter their behaviors based upon the nature, amount, and timing of benefits received under nondiscretionary loyalty programs. Often gaming entities are able to monitor and accumulate customer activity through the use of their loyalty programs, which provides a deeper understanding of customers and enhances their ability to further market to customers in general. Even though each loyalty credit awarded to a customer may represent only a small component of any individual transaction (common rates are in the range of 1 percent of the amount wagered), the overall magnitude of these programs is generally material to gaming entities. Based on the overall size, the qualitative assessment of the marketing impact of such programs to gaming entities and the related value placed on such programs by customers, FinREC believes nondiscretionary incentives provide a material right to a

(footnote continued)

herein it is easiest to form the contract in terms of individual wagering transactions, there are often additional complexities to arrangements made with a customer that may warrant consideration of multiple wagers by a customer over a short period of time in order to appropriately consider and allocate revenue to varying revenue centers consistent with the separate performance obligations of the casino in the contracts.

customer that the customer would not receive without entering into that contract, and therefore is a performance obligation of the contract.¹⁴

Determine the Transaction Price

6.6.16 FinREC believes the total transaction price is equal to the amount wagered by the customer, which would be \$10,000 less the amounts returned to (won by) the customer, or \$9,300 in this example. This belief is based upon an assessment of FASB ASC 606-10-32-25, which states that an entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 18–22 of FASB ASC 606-10-25) that the customer transfers to the entity. Because the amounts returned to the customer are not in exchange for distinct goods or services, FinREC believes these are a reduction to the transaction price. Thus, the transaction price in this example is \$700.

6.6.17 Because of the nature of the transactions in the gaming industry, it is possible for a gaming entity to have no or even negative revenue associated with transactions. When loyalty credits are provided to a customer on such transactions, it is therefore possible that a negative transaction price could be a result of loyalty programs. FASB ASC 606 does not address the presentation of revenue in a contract resulting in a negative transaction price. FinREC believes that given the gaming industry's specific facts and circumstances (including the business model and the nature of the contracts entered into by gaming entities) it is appropriate for gaming entities to present this negative transaction price as a component of net revenue.

Allocate the Transaction Price to Performance Obligations

6.6.18 FASB ASC 606-10-32-29 requires an entity to allocate the transaction price to performance obligations on a relative standalone selling price basis. As discussed in FASB ASC 606-10-55-44, if the standalone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity would estimate it.

6.6.19 In this example, the gaming entity would allocate the \$700 transaction price between the gaming transaction and the incentives based upon their respective standalone selling prices. In the gaming industry, there may be further complicating factors regarding the determination of the standalone selling prices for the gaming transaction and the loyalty credits.

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

6.6.20 Amounts allocated to the potential incentives would be recognized as the performance obligations are satisfied. FinREC believes the performance obligations in a typical gaming transaction where the customer is a member of a loyalty program which offers nondiscretionary incentives are satisfied as follows:

¹⁴ This analysis is consistent with view B under question 2 in the FASB/IASB Joint Transition Resource Group for Revenue Recognition Agenda Ref 6: "Customer options for additional goods and services and nonrefundable upfront fees."

<i>Performance Obligation or Rebate</i>	<i>Satisfaction of the Performance Obligation or Rebate</i>
Gaming element	Customer plays the game or spins and dealer or house settles all wagers.
Free play	Customer plays the free game or spin.
Complimentaries	The customer consumes the service provided by the casino as a complimentary (room night, free buffet, or the like).
Loyalty credits	Customer consumes those credits for a good or service.
Cash or cash equivalents	The later of payment (or promise of payment) or revenue recognition in accordance with FASB ASC 606-10-32-27 as a rebate.

6.6.21 The following journal entries exemplify the accounting described previously (note that the recognition of the liability upon satisfaction of the performance obligation would be in the same location as the revenue source—entries are examples and do not encompass all incentive types) based on an assumed allocation of \$87.50 to the incentive. A complicating factor arises when a cash incentive could be selected by the customer because any cash incentives would be accounted for under FASB ASC 606-10-32-25 as consideration payable to a customer and therefore would be a reduction of the transaction price prior to any allocation to the performance obligations. See the following examples of associated journal entries:

Customer plays slot and earns a noncash incentive

	<i>DR.</i>	<i>CR.</i>
Cash	700	
Gaming revenue		612.50
Loyalty program—Performance obligation		87.50

Customer redeems loyalty points for buffet

	<i>DR.</i>	<i>CR.</i>
Loyalty program—Performance obligation	87.50	
Revenue		87.50

Customer plays slots and earns a cash incentive

	<i>DR.</i>	<i>CR.</i>
Cash	700	
Gaming revenue		600
Customer rebate liability		100

Casino provides cash to customer

	<i>DR.</i>	<i>CR.</i>
Customer rebate liability	100	
Cash		100

For this example, we have assumed the relative standalone selling prices are as follows:

- Gaming activities: 87.5%
- Loyalty points: 12.5%

We have also assumed that the cash incentive earned by a customer is \$100 primarily to indicate that for cash incentives there is no relative standalone selling price allocation.

Allocation of the Transaction Price of Gaming Transactions Included Within a Nondiscretionary Loyalty Program to the Various Performance Obligations

6.6.22 FASB ASC 606-10-32-29 requires that the transaction price (that is, "net win") is to be allocated on a relative standalone selling price basis. In order to perform this allocation, a gaming entity must first determine the standalone selling prices. Building on the basic fact pattern from our first example, we will change our assumptions as follows:

- Customer played \$10,000 on a slot machine.
- Customer received \$9,300 in cash payouts.
- Customer earned 10,000 credits entitling the customer to future incentives; however, there is no assumption as to the value or selling price of such loyalty credits in this example.

Estimation of the Standalone Selling Price of Loyalty Credits When Not Sold on a Standalone Basis

6.6.23 If the nondiscretionary loyalty program provides credits and those credits are not sold on a standalone basis, an entity must estimate the standalone selling price. FinREC believes that because of the limited availability of separate sales of loyalty credits (credits sold without any form of a marketing component), the standalone selling price can be determined based upon the observable inputs used to determine the redemption value of the award. In many cases, the value of a loyalty credit is actually predetermined based upon a redemption conversion rate, such as \$0.01, meaning a customer can redeem them for goods and services at a set exchange ratio. In such a case, a gaming entity would still need to assess the value and the expected redemptions but would likely look to transactions in which customers have purchased the same item or component being redeemed for loyalty credits. One method of doing this is to aggregate the value of all redemptions of awards by redemption type for a specific period of time and divide this amount by the total loyalty credits actually redeemed. See the following example of the determination of the transaction price of loyalty credits included in a program in which the customer has the option of multiple types of noncash incentives upon redemption. Included within this example is the assumption that 20 percent of all awarded loyalty credits expire unused (that is, they are not expected to be redeemed):

	<i>Average Selling Price of Incentive</i>	<i>Loyalty Credits Necessary for Award Redemption</i>	<i>Average Value of Loyalty Credits to Redeem</i>	<i>% of Awards Redeemed for This Incentive</i>	<i>Weighted Average</i>
Hotel Rooms	\$150	15,000	\$0.010	50%	\$0.0050
Free Buffet	\$50	10,000	\$0.005	40%	\$0.0020
Merchandise	\$100	13,333	\$0.008	10%	\$0.0008
					\$0.0078
Percent of Loyalty Credits Expected to be Fulfilled					80%
Redemption Value of Each Loyalty Credit Expected to be Redeemed					\$0.0062

6.6.24 FinREC believes the output from this calculation as updated on a routine basis or when conditions require a revision to the estimate, would maximize observable inputs consistent with FASB ASC 606-10-32-33 because both of the primary factors used in this calculation are directly observable (the average selling price of the redeemed goods and the number of loyalty credits actually used in their redemptions), and therefore this estimate of the standalone selling price is effectively an observable price of the points. FinREC believes that the percentage of credits expected to be fulfilled would also be an observable input if it is based on past observed history that the entity believes to be indicative of future expectations.

6.6.25 Accordingly, in this example, the separately observed selling price for the loyalty credits (which was assumed for simplicity to be \$100 in paragraph 6.6.10) would be \$62 (10,000 credits × \$0.0062 value per loyalty credit as estimated in the chart in paragraph 6.6.23).

6.6.26 This would result in the following step 4 allocation (similar to example 52 detailed in paragraphs 353–356 of FASB ASC 606-10-55), with emphasis on the ultimate objective resulting in an allocation of the portion of the transaction price allocated to the gaming activity that is consistent with the relative selling price principle underlying FASB ASC 606-10-32-31.

	<i>Amount</i>	<i>Percent</i>	<i>Transaction Price</i>	<i>Allocation of Transaction Price</i>
Selling Price of Slot Gaming Activity	\$700	91.9%	\$700	\$643.04
Selling Price of Loyalty Credits (Incentive)	\$62	8.1%	\$700	\$56.96
	\$762			\$700

6.6.27 In our simplified transaction, this allocation is easily accomplished because the individual is engaged in slot activity, unlike table games, which are more subjective (see table games explanation in paragraph 6.6.11). Gaming entities are generally able to monitor and accumulate an individual's slot transactions earning loyalty credits because a customer is required to insert a loyalty card in the slot machine to be able to earn loyalty credits; accordingly, the gaming entity will likely have sufficient information by which it can allocate the transaction price for slot activity.

6.6.28 This example is intentionally skewed to show an approach with hypothetical assumptions that result in approximately 92 percent of the total relative selling price being applicable to gaming activity. In practice, however, the proportion of gaming revenue as a percentage of the total relative selling prices is overwhelmingly attributable to gaming (analyses have indicated this can exceed 98 percent). Because the proportion of gaming revenue (total transaction price in such transactions) as compared to the total relative selling prices is overwhelmingly attributable to gaming, there is virtually no difference between allocating transaction price under this hypothetical individual transaction approach or a portfolio approach which would be applied in practice.

Estimation of the Standalone Selling Price of Gaming Activity

6.6.29 FASB ASC 606-10-32-34 notes that suitable methods for estimating the standalone selling price of a good or service include the following:

- a.* Residual approach. An entity may estimate the standalone selling price by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate, in accordance with paragraph FASB ASC 606-10-32-33, the standalone selling price of a good or service only if one of the following criteria is met:
 - i.* The entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (that is, the selling price is highly variable because a representative standalone selling price is not discernible from past transactions or other observable evidence).
 - ii.* The entity has not yet established a price for that good or service and the good or service has not previously been sold on a standalone basis (that is, the selling price is uncertain).

6.6.30 FinREC believes that the criteria in FASB ASC 606-10-32-34c(i) will be achieved in many gaming transactions and therefore the determination of the standalone selling price for the gaming activity is appropriately determined using the residual approach by subtracting the value of the loyalty credits based upon their separately observed standalone selling price as exhibited previously (the \$0.0062 in our example) from the net gaming revenue amount resulting in a residual amount determined to be the value ascribed to the gaming element in order to determine the selling price of the gaming activity. FinREC believes this approach meets the allocation objectives of FASB ASC 606-10-32-28 and would only be appropriate in conjunction with gaming

transactions when the gaming entity has observable selling prices for goods or services underlying the redemption of loyalty credits based on cash or cash equivalent (non-loyalty redemption) transactions for such goods and services with other customers, and the gaming entity has objective historical experience to apply when determining the percentage of credits expected to be fulfilled.

6.6.31 In a scenario in which a gaming entity is unable to determine the standalone selling price of the individual gaming activities, often a gaming entity will be required to estimate the total transaction price (based on aggregated transaction data) and determine the selling price of the gaming activity as described previously. An example of this follows:

	<i>Amount</i>	<i>Selling Price</i>	<i>Relative Selling Prices</i>
Total Transaction Price (Estimate)	\$700		
Selling Price of Loyalty Credits (Incentive)	\$62	\$62	8.9%
Selling Price of Gaming Activity (Residual Approach)	\$638	\$638	91.1%

Gaming Industry Factors That Impact the Allocation of Total Transaction Price (Time Period of Allocation Measurement Before the Assessment of Overall Allocation Objectives)

6.6.32 As paragraph 6.6.11 describes, a gaming entity often will lack the same level of information (net win, or transaction price) that it obtains for slot transactions for transactions on table games or other types of gaming activities which also earn loyalty credits. This requires the gaming entity to estimate the total transaction price (using aggregated transaction data) that must be allocated to the performance obligations in other gaming transactions.

6.6.33 In addition, the amount of loyalty credits a customer earns is entirely uncorrelated with the transaction price (in general, for slot activity, the loyalty credits earned are a function of coin-in, or drop). This lack of correlation is exhibited as follows, assuming that a customer earns one credit for each dollar of coin-in. Such a situation has three potential outcomes (a) customer wins, (b) house wins, or (c) break-even.

	Scenario 1 <i>Customer Wins</i>	Scenario 2 <i>House Wins</i>	Scenario 3 <i>Break Even</i>
Coin-in	\$10,000	\$10,000	\$10,000
Coin at Cessation of Play	\$11,000	\$9,300	\$10,000
Gross Gaming Revenue	\$(1,000)	\$700	\$0
Credits Earned	10,000	10,000	10,000

6.6.34 As exhibited in paragraph 6.6.33, in gaming transactions, individual customers can win, lose, or break-even—but in the aggregate, the gaming entity holds an advantage in each game of chance, and will, over the long-term, win more from customers than it loses to customers. As noted previously, a

gaming entity generally is able to monitor and accumulate player volume (drop) and length of play. This enables a gaming entity to grant loyalty credits to customers because the loyalty credits are generally a function of drop as opposed to gross gaming revenue or net gaming revenue. The examples included assume that each customer's transactions on a daily basis are aggregated as a portfolio of similar transactions under FASB ASC 606-10-10-4.

6.6.35 This complete fact pattern results in the following application issues in the gaming industry:

- a. Period of measurement in which to apply allocation guidance for nondiscretionary incentives issued in conjunction with gaming or nongaming activities. As described in "Definitions: The Terms *Win* and *Gross Gaming Revenue*" (paragraphs 6.6.01–6.6.08), in order to facilitate the efficient and optimal gaming experience to the gaming entity and its customers, individual betting transactions at many games are not recorded and separately identified. Accordingly, the components that determine net win or loss to the gaming entity for the day at an individual game are accumulated within a secured lock box at tables. Daily the lock box is removed and its contents separated and counted and a determination of the net win or loss at the table is made and recorded for the day. FinREC believes that the allocation of the transaction price associated with nondiscretionary incentives to transactions that include such nondiscretionary incentives is most appropriately performed over the same period in which gross gaming revenue is determined.
- b. A customer may win from the gaming entity; that is, no net consideration is received by the gaming entity for a transaction. Because a customer can win from the gaming entity on an individual transaction, there can be scenarios in which there would be no transaction price to allocate (that is, the gaming entity would receive no net consideration). As described in "Definitions: The Terms *Win* and *Gross Gaming Revenue*" (paragraphs 6.6.01–6.6.08), FinREC believes that the transaction price allocated to the gaming activity (which in some cases can be negative), would not be reclassified to expense; rather such amounts would be included as a component of net gaming revenue.
- c. Highly uncorrelated nature between gross gaming revenue and the value of loyalty credits. Due to the highly variable nature of gaming results (see the three prior scenarios), there is limited to no correlation between transaction price and the value of loyalty credits awarded.

6.6.36 Though a gaming entity may be able to estimate the standalone selling price of loyalty credits granted through the use of the redemption conversion rate or through a redemption analysis, because of the inherent nature of gaming transactions (the same exact transaction can have three entirely different outcomes as previously depicted) and because gaming entities do not track the outcome of each individual transaction, FinREC believes the objective of allocating transaction price to performance obligations is best achieved through allocating transaction price on a more aggregated basis, which is generally each day.

Assessment of Allocation Objectives and the Impact That Assessment Has on the Allocation of Transaction Price

6.6.37 Leveraging the basic fact pattern and assumptions in paragraph 6.6.21 (including the usage of the residual approach in determining the selling price of the gaming activity), the five steps of FASB ASC 606 would be assessed as follows.

6.6.38 The analysis of identifying the customer and the performance obligations in the contract are the same as in paragraphs 6.6.12–6.6.13, accordingly this analysis begins with "Step 3: Determine the Transaction Price." Assume the same facts as in paragraph 6.6.31, which results in the determination of selling prices as per paragraph 6.6.31 summarized as follows:

	<i>Amount</i>	<i>Selling Price</i>	<i>Relative Selling Prices</i>
Total Transaction Price (Estimate)	\$700		
Selling Price of Loyalty Credits (Incentive)	\$62	\$62	8.9%
Selling Price of Gaming Activity (Residual Approach)	\$638	\$638	91.1%

6.6.39 Because a gaming entity will use a longer period of time in which to allocate transaction price (see paragraph 6.6.35), the gaming entity will likely have a cumulative positive outcome for those transactions earning loyalty points (that is, the house wins). However as noted throughout, the transaction price will likely require some level of estimation. In this case, we assume the total transaction price to allocate is \$700. The following table exemplifies the allocation (step 4) using the residual approach to determine the selling price for the gaming activity:

	<i>Relative Selling Prices</i>	<i>Transaction Price</i>	<i>Allocated Value</i>
Selling Price of Loyalty Credits (Incentive)	8.9%	\$700	\$62
Selling Price of Gaming Activity (Residual Approach)	91.1%	\$700	\$638
			\$700

6.6.40 As previously noted, a gaming entity will generally use a longer period of time and an aggregation of transactions to determine (1) the relative selling prices, (2) the amount to allocate to each performance obligation, and (3) the total transaction price to be allocated.

6.6.41 Because there are two scenarios in which loyalty points will be awarded to customers without there being a positive transaction price, Fin-REC believes that if such a measurement period arose, the same value per point/credit awarded as determined in paragraph 6.6.38 should be applied to

those measurement periods, resulting in a single allocated value per loyalty point.

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

6.6.42 Some gaming entities have nondiscretionary incentive programs that provide customers with a choice of free play, cash, complimentary, or other goods or services. Accordingly, the type of incentive the customer will choose is not known at the time of the gaming transaction in which the customer earned the incentive.

6.6.43 The analysis of identifying the customer, identifying the performance obligations in the contract, and determining the transaction price are the same as in paragraphs 6.6.12–6.6.13 and 6.6.16, accordingly this analysis begins with "Step 4: Allocate the Transaction Price to Performance Obligations."

Allocate the Transaction Price to Performance Obligations

6.6.44 When cash cannot be selected as the incentive, FinREC believes that the gaming entity will need to estimate the amounts and types of benefits it expects to provide, most often based upon history. This information would form the basis for the determination of the standalone selling price of those performance obligations in a similar manner as described in paragraph 6.6.23.

6.6.45 In circumstances in which cash can be selected, FinREC believes the gaming entity would generally leverage its historical transactions as a basis to estimate the number of customers that will elect to receive cash. In such circumstances, the entire value of the future cash estimated to be received by the customer would be a reduction to the transaction price prior to any allocation to the performance obligations in the same manner as a rebate or discount.

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

6.6.46 FinREC believes that any amounts allocated to performance obligations would be recognized in the same manner as described in paragraphs 6.6.18–6.6.19, updated in accordance with paragraphs 355–356 of FASB ASC 606-10-55.

Accounting for Discretionary Incentives Issued in Conjunction With Gaming and Nongaming Activity

6.6.47 A gaming entity will often offer incentives to customers outside of its loyalty program in order to provide an incentive to induce future play. Such incentives may be in the form of offers mailed to potential customers or complimentary meals offered to customers after several hours of playing slot machines. Regardless of the type of the offer, the objective for the gaming entity is to induce future play or future levels of 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, accordingly no liability would be recorded based upon the offer being made.

6.6.48 FinREC believes that discretionary incentives (as described herein), even when offered based on a company's assessment of past play are, nevertheless, given to induce current or future play, rather than as an obligation based on past play because, prior to offering the incentive the gaming entity

was under no obligation to do so. FinREC further believes that such offers are not performance obligations prior to the customer's redemption or obligating acceptance of the offer as described in FASB ASC 606, nor are they implied performance obligations as described in FASB ASC 606-10-25-16 because the gaming entity's customary business practices do not generally create a valid expectation of the customer that the entity is required to make such offer or is required transfer a good or service to the customer.

6.6.49 At the point of redemption of such marketing offers, a gaming entity creates a performance obligation and thus any associated transaction price for that measurement period should be allocated by the gaming entity across all goods or services delivered to customers on a standalone selling price basis.

6.6.50 FinREC believes that in gaming, the cost of the discretionary incentive is recognized as an expense at the time the related revenue is recognized because the offer is a normal marketing incentive and not a material right that is the result of a past transaction (and thus the guidance described in FASB/IASB TRG Agenda Ref 54 as described in paragraph 6.6.14 of this chapter applies).

Accounting for Loyalty Points Redeemed With Third Parties

This Accounting Implementation Issue Is Relevant for Application of FASB ASC 606 to Loyalty Points Redeemed with Third Parties.

6.6.51 The section "Loyalty Credits and Other Discretionary Incentives (Excluding Status Benefits)" in paragraphs 6.6.09–6.6.50 addresses the initial accounting for the earning of loyalty points. This section addresses a narrow scope resultant issue and assumes that the gaming entity has a pre-existing performance obligation liability for outstanding loyalty points previously awarded.¹⁵

Background

6.6.52 A casino customer is a member of that casino operator's customer loyalty program. The casino operator's customer loyalty program grants points to the customer based upon play that has been completed (usually contemporaneous with such play). Once earned, such points can be redeemed by the customer for a number of different types of incentives with both the gaming entity and third parties that participate in the gaming entity's "loyalty network."

6.6.53 Frequently, gaming entities own shopping malls or food and beverage outlets attached to its casino and lease this space to retail operators who pay the gaming entity rent. To make the loyalty program more attractive to its customers and potentially draw more loyal members, gaming entities may enroll these retail operators in its loyalty network. Generally, under the terms of the loyalty program, loyalty program customers may redeem loyalty points with participating third parties in lieu of such customer paying those parties cash. In turn, the gaming entity then is required to make payments to the participating third party based on a formula in the arrangement in order to reimburse such participant for fulfilling the loyalty obligation on the casino's behalf.

¹⁵ Paragraph 6.6.23 indicates that the initial valuation of loyalty credits includes the gaming entity's assessment of unexercised rights (breakage). Paragraph 6.6.14 indicates that loyalty credits are a performance obligation subject to FASB ASC 606, as such loyalty credits represent a material right that would not exist independent of an existing contract with a customer.

Principal Versus Agent

6.6.54 FASB ASC 606-10-55-36 states:

When another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods or services to be provided by the other party (that is, the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 19–22 of FASB ASC 606-10-25). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

6.6.55 As stated in FASB ASC 606-10-55-37, "an entity is a principal if it controls the specified good or service before that good or service is transferred to the customer."

6.6.56 Also, FASB ASC 606-10-55-37B states: "When (or as) an entity that is a principal satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred."

6.6.57 FASB ASC 606-10-55-38 states:

An entity is an agent if the entity's performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

6.6.58 A sponsoring gaming entity ("Sponsor") must assess whether it obtains control of the good or service being redeemed by its loyalty program member ("Member") with a third party ("Network Partner") before that good or service is transferred to the Member. If a Sponsor obtains control of the good or service in advance, it would record revenue and expense on a gross basis. The Sponsor would need to evaluate its third-party contracts under the principal versus agent considerations in paragraphs 36–40 in FASB ASC 606-10-55 in order to make a gross versus net determination.

6.6.59 FinREC believes that a Member's redemption of loyalty points with a Network Partner under a typical loyalty program transaction described in paragraph 6.6.53 should generally be presented as a net activity in the Sponsor's income statement, because the Sponsor generally does not control the specified good or service before that good or service is transferred to the Member in accordance with FASB ASC 606-10-55-38, as evidenced by the Network Partner having primary responsibility for fulfilling the good or service, including making any reparations if the good or service is found to be unacceptable.

However, a Sponsor should assess its specific facts and circumstances in reaching its conclusion.

6.6.60 FASB ASC 606-10-55-36A provides that the assessment of principal versus agent criteria is based on an assessment of who controls "each specified good or service before that good or service is transferred to the customer." This assessment cannot be made at the time the loyalty credit is issued because the customer has not determined the "specified goods or services" to be delivered. The gaming entity evaluates whether it acts as an agent or principal in regard to the selected service or product when the selected service or product is known, which is at the time of redemption by the customer. This is further supported by the following views expressed in paragraph BC385 of ASU No. 2014-09:

In other cases, the points may entitle customers to choose between future goods or services provided by either the entity or another party. The Boards observed that, in those cases, to determine when the performance obligation is satisfied, the entity would need to consider the nature of its performance obligation. This is because until the customer has chosen the goods or services to be provided (and thus whether the entity or the third party will provide those goods or services), the entity is obliged to stand ready to deliver goods or services. Thus, the entity may not satisfy its performance obligation until such time as it either delivers the goods or services or is no longer obliged to stand ready. The Boards also observed that if the customer subsequently chooses the goods or services from another party, the entity would need to consider whether it was acting as an agent and thus should recognize revenue for only a fee or commission that the entity received from providing the services to the customer and the third party.

6.6.61 When a Sponsor acts as an agent in regard to its Member's loyalty redemptions with Network Partners, FinREC believes the Sponsor should recognize the net difference between the relieved liability associated with the loyalty points and the amount remitted to the Network Partner as other revenue from contracts with customers. The net amount would be recognized as other revenue from contracts with customers at the date when the performance obligation is transferred to the Network Partner and the Sponsor is no longer obliged to stand ready to deliver goods or services (which would generally be the redemption date), consistent with the guidance in FASB ASC 606-10-55-40. See illustration of this in example 6-6-4—Entries to Record Redemption of Loyalty Points.

6.6.62 The following example is meant to be illustrative, and the actual determination of the appropriate accounting for the loyalty points under FASB ASC 606 should be based on the facts and circumstances of an entity's specific situation.

Example 6-6-4—Entries to Record Redemption of Loyalty Points¹⁶

Assume that a customer has 40,000 loyalty points as a result of past qualifying activity. Also, assume that the gaming entity sponsoring the loyalty program

¹⁶ For illustrative purposes, this example assumes a redemption transaction with a single retailer at the terms specified. The gaming entity may have agreed with other retailers in the mall on different terms and conditions, which would have to be considered for redemptions with such other retailers.

has previously determined that the value of each loyalty point is \$.01/point, which has resulted in a liability being recorded for the preceding customer totaling \$400, as a result of a total of \$4,000 in combined gaming, hotel, and food and beverage activity. For purposes of this example only, assume that the \$4,000 total transaction price yielded an allocation of \$400 to the loyalty points and \$3,600 to the associated revenue-generating activity, based on the relative selling prices of those performance obligations.

Paragraph 6.6.17 states:

Because of the nature of the transactions in the gaming industry, it is possible for a gaming entity to have no or even have negative revenue associated with transactions [with customers]. When loyalty credits are provided to a customer on such transactions, it is therefore possible that a negative transaction price could result from the loyalty programs. FASB ASC 606 does not address the presentation of revenue in a contract resulting in a negative transaction price. FinREC believes that given the gaming industry's specific facts and circumstances (including the business model and the nature of the contracts entered into by gaming entities), it is appropriate for gaming entities to present this negative transaction price as a component of net revenue.

Also assume the following:

- a.* Customer redeems all 40,000 loyalty points at a retail outlet enrolled in the Gaming Entity's loyalty network ("Retailer") for a leather day planner.
- b.* Retailer determines the price of the day planner.
- c.* Gaming Entity does not have any input into the operations of Retailer, except to the extent allowed or provided for in the customary lessor/lessee rental agreement, and has no responsibilities to the customer for product liability or customer satisfaction.
- d.* Gaming Entity does not specifically track each individual point (that is, it does not know which specific point has been redeemed; rather, it pools points).
- e.* Gaming Entity does not commit to a certain level of loyalty point redemptions at Retailer nor does it acquire any goods or services from Retailer.
- f.* Gaming Entity then remits \$300 to Retailer for fulfillment of points redeemed at Retailer. (Gaming Entity pays Retailer for fulfillment at \$0.0075 per point.)

Based on the preceding facts and consistent with paragraph 6.6.59, the gaming entity concludes it is an agent, as the gaming entity does not control the good or service from the third-party retailer before it is transferred to the customer upon redemption of the loyalty points. Therefore, in accordance with FASB ASC 606-10-55-38, the transaction with the third-party retailer should be presented on a net basis.

See the following journal entries:

Initial entries to record the point liability	Dr.	Cr.
Cash	\$4,000	
Gaming, hotel, food revenue		\$3,600
Loyalty program-performance liability		\$400
Gaming entity records revenue for loyalty credit-earning activity based on fair value of each performance obligation		
	Dr.	Cr.
Entries to record redemption of loyalty points	\$400	
Loyalty program-performance liability		\$400
Other revenue from contracts with customers		
Gaming entity pays retailer to fulfill point loyalty obligation		
Other revenue from contracts with customers	\$300	
Cash		\$300
Gaming entity reacquires redeemed points from retailer		

Because Gaming Entity originally allocated \$400 of cash transactions to the loyalty point performance obligation, the total other revenue from contracts with customers ultimately recognized when a customer redeems at a third party is equal to the difference between the amount allocated to the performance obligation and the amount paid to the third party to fulfill it, which in this case is \$100.

Accounting for Loyalty Co-branding Arrangements

This Accounting Implementation Issue Is Relevant for Application of FASB ASC 606 to Loyalty Co-branding Arrangements.

6.6.63 Gaming entities with large loyalty programs may enter into agreements with a co-branded credit card partner in which loyalty credits and other consideration (for example, discounted gaming, room upgrades, resort fee waivers, loyalty lounge access, branding and marketing services) are sold to a financial institution. The credits are then issued to the financial institution's credit card customers, who are also gaming loyalty members, as they make purchases on their co-branded credit cards. In these co-branded contracts, certain services, principally advertising and branding, including access to the gaming entity's customer list, are used directly by the financial institution. The services sold to the financial institution help its credit card business obtain new and more profitable customers and promote increased spending on credit cards. Co-branded credit cards are often more profitable to financial institutions than a typical credit card portfolio and, as such, they are willing to pay the gaming entity for the access to its customers and the brand of the gaming entity. During the multi-year term of these contracts, the financial institution is granted continual access to the customer list.

6.6.64 Co-brand agreements involve three parties and two customers from the gaming entity's perspective. The parties to the agreement include a gaming entity sponsoring the credit card (sponsor), a financial institution, and the

credit card holder (holder). The financial institution is the customer of the gaming entity for the sale of marketing-related deliverables, including brand, customer list, and advertising elements that increase the value of the financial institution's credit card portfolio. The credit card holder is the customer of the gaming entity for the earning of points under its loyalty agreement (provided and paid for by the financial institution), which accrue to the loyalty member's account each time he or she uses the credit card, based on a specified exchange rate. There are three contracts within co-brand agreements: (1) the sponsor and the holder have a loyalty contract (that is, the holder must also be a loyalty member in order to obtain the benefits of a co-branded credit card because the holder must have an account in which to deposit loyalty credits earned as a result of using the co-branded credit card), (2) the financial institution and the sponsor are parties to the co-branded credit card contract, and (3) the financial institution and the holder are parties to a credit contract. FASB ASC 606 and the FASB ASC Master Glossary define a contract as "[a]n agreement between two or more parties that creates enforceable rights and obligations." All of these agreements meet the definition of a contract and the criteria in FASB ASC 606-10-25-1 because they create enforceable obligations on the various parties.

6.6.65 In the case of loyalty credits sold by the sponsor to the financial institution, the loyalty credits are ultimately awarded to the credit card holders, who are also gaming loyalty members, based on their credit card purchases or other activities. Loyalty credit awards are supplied by the sponsors, which also determine the range of goods and services for which the loyalty credits can be redeemed and the number of loyalty credit awards required to be redeemed for various awards in their programs. The holder has no recourse to the financial institution but must look exclusively to the sponsor for the satisfaction of the loyalty credits obligation. Therefore, the nature of the promise by the sponsor with respect to loyalty credits to be provided in a co-branded credit card agreement is the right to acquire future underlying goods or services for which the loyalty credits may be used rather than the loyalty credit itself.

6.6.66 Under co-branded credit card agreements, the payments for various services (brand and advertising provided to the bank and loyalty credits provided to the credit card holder) are generally made at the time the credits are awarded to the customer accounts. Payment is made to the sponsor exclusively by the financial institution. These payments generally include full consideration for selling all the services provided to the financial institution and the loyalty member. At the time of the sale, the sponsor will allocate the revenue under the agreements to the bank and loyalty members/credit card holders and recognize revenue under the applicable recognition criteria.

6.6.67 The two most significant performance obligations in co-branded credit card arrangements are the sale of the credits to the financial institution and the right granted by the sponsor to the financial institution to use its brand and customer list. (Paragraphs 6.6.14–6.6.15 of the section "Loyalty Credits and Other Discretionary Incentives (Excluding Status Benefits)," discuss why a loyalty credit represents a separate performance obligation, and the section "Consideration of Whether the Brand and Customer List Are Distinct Services" addresses why the brand and customer list represent a separate performance obligation [referred to as the brand performance obligation].) Compensation for the two main performance obligations under co-branded credit card agreements is paid at the time when a co-branded credit card is used by the holder and

coincides with when the financial institution collects its merchant fee on the transaction. As a result, the sponsor receives the vast majority of the consideration for the two main performance obligations as the co-branded credit card is used. The performance obligation related to loyalty credits is satisfied when or as the underlying goods or services have been provided and the loyalty credit has been retired (generally when the related redemption occurs and the free or discounted goods or services are provided to the loyalty customer), whereas the performance obligation or obligations related to the brand elements, other marketing services, and ancillary services are satisfied over time. Therefore, the portion of the consideration attributable to the brand performance obligation is recognized over time (as the co-branded credit card is used), whereas the portion of the consideration attributable to the loyalty credit is deferred until the point in time when it is redeemed for goods or services.

Maintenance of Customer List Database

6.6.68 Under most co-branded credit card agreements, a sponsor is required to provide the financial institution with regular access to its loyalty program customer list and allow the use of its brand (the gaming entity's name, logo, and so on) throughout the term of the agreement. The first step in identifying performance obligations is to identify the goods or services promised in the contract. FASB ASC 606-10-25-16 states that

the promised goods or services identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer also may include promises that are implied by an entity's customary business practices, published policies, or specific statements if, at the time of entering into the contract, those promises create a reasonable expectation of the customer that the entity will transfer a good or service to the customer.

6.6.69 In determining the appropriate accounting for the function of maintaining a customer list database, gaming entities should consider the guidance in FASB ASC 606-10-25-17, which states

[p]romised goods or services do not include activities that an entity must undertake to fulfill a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not promised goods or services in the contract with the customer.

6.6.70 Consistent with the guidance in FASB ASC 606-10-25-17, administrative tasks that a sponsor must undertake to fulfill a contract that do not transfer goods or services to the customer are not considered promised goods or services in the contract with the customer but rather fulfillment activities. This is due to the fact that the financial institution issuing the co-branded credit card could not benefit from the sponsor performing maintenance and administrative tasks associated with the customer list. The task of maintaining and updating the sponsor's loyalty database or member list is performed routinely by the sponsor regardless of whether the sponsor is a party to a co-branded agreement. FinREC believes that the promised service the sponsor provides is the access to the customer list and the use of the sponsor's brand name over

the contract period, which meets the requirements in FASB 606-10-25-19 (because the financial institution can benefit from the access to the customer list and the use of the brand name and it is a distinct promise in the contract) and, therefore, represents a separate performance obligation. As discussed in paragraph 6.6.79, FinREC also believes that the combination of the brand name and customer list represents symbolic intellectual property (IP) because it does not have significant stand-alone functionality, and substantially all the benefits to the financial institution are derived from its access to the customer list and brand name, which are supported by the sponsor's ongoing activities, including its ordinary business activities.

Consideration of Whether the Brand and Customer List Are Distinct Services

6.6.71 FASB ASC 606-10-25-14 states the following:

At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- a. A good or service (or a bundle of goods or services) that is distinct
- b. A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 606-10-25-15).

6.6.72 As discussed in the following paragraphs, in the gaming co-branded credit card example, the use of the brand is not separable from the access to the sponsor's loyalty program customer list, which is used by the financial institution to target the sponsor's customers in order to solicit credit card business.

6.6.73 Generally, a significant portion of the value to the financial institution in these arrangements comes from its right to market to the sponsor's loyalty members, which is provided through access to the sponsor's customer list. Frequently, the majority of a sponsor's most profitable customers are also members of the sponsor's loyalty program and often are high-wealth individuals. This is often one of the more important factors that lead to significant value being ascribed to these co-branded agreements. Additionally, strong brand recognition helps drive both new and repeat customer visitation to the gaming entity's properties, resulting in significant value associated with access to the sponsor's customer list.

6.6.74 FinREC believes that the integration of the sponsor's brand and access to its customer list into the co-branded credit card agreement generally meets the "highly interdependent or highly interrelated" criteria in FASB ASC 606-10-25-21(c). This is because the utility of the access to the customer list and use of the brand (and, therefore, the ability for each to provide value) are dependent on each other. That is, the value of the two combined together significantly exceeds the sum of the value that could be ascribed to each individually. Therefore, FinREC believes that the use of the sponsor's brand and access to its customer list are not distinct and, as such, should be combined into a single performance obligation, subsequently referred to in this guide as the "brand performance obligation." Access to the customer list and use of the brand are referred to as the "brand elements."

Revenue Recognition for Brand Performance Obligation

6.6.75 FASB ASC 606-10-55-54 states

[l]icenses of intellectual property may include, but are not limited to, licenses of any of the following:

....

- d. Patents, trademarks, and copyrights.

6.6.76 Consistent with the guidance in FASB ASC 606-10-55-54, FinREC believes that the right granted by the sponsor to the financial institution to use its brand elements as part of the co-branded credit card agreement qualifies as licensing of the sponsor's IP. The co-branded credit card partner uses the brand elements (including the sponsor's logo, on individual credit cards as well as in various marketing-related materials) to help market the co-branded credit card. The use of the brand elements is beneficial to the financial institution due to association with the sponsor and its loyalty program members.

6.6.77 As explained in FASB ASC 606-10-55-58, licenses of IP represent either a promise to provide a right to use an entity's IP, which is satisfied at a point in time, or a promise to provide a right to access the entity's IP, which is satisfied over time. Consistent with FASB ASC 606-10-55-58, the key consideration in determining the revenue recognition pattern is whether the nature of the entity's promise in granting the license is to provide a customer with a right to access an entity's IP throughout the license term or a right to use an entity's IP as it exists at the point in time at which the license is granted.

6.6.78 When determining the nature of the sponsor's promise in granting the license to the financial institution customer, sponsors should follow the guidance in paragraphs 59–63A of FASB ASC 606-10-55. FinREC believes that the combination of the brand name and customer list represents symbolic IP (which is described in FASB ASC 606-10-55-59(b)) because it does not have significant stand-alone functionality, and substantially all the benefits to the financial institution are derived from its access to the brand name and customer list, which are supported by the sponsor's ongoing activities, including its ordinary business activities. FASB ASC 606-10-55-60 provides that "a license to symbolic intellectual property grants the customer a right to access the entity's intellectual property, which is satisfied over time." Therefore, based on the guidance in paragraphs 58–58A of FASB ASC 606-10-55, consideration for symbolic IP should be recognized as revenue over the license period using a measure of progress that reflects the licensor's pattern of performance.

6.6.79 In addition to the brand performance obligation, co-branded agreements include a separate performance obligation related to the sale of the loyalty credits to the financial institution (which are issued to the sponsor's loyalty customers who then redeem them for gaming, lodging, dining, and other goods and services). The co-branded agreement may also include separate performance obligations related to other marketing-related services or the provision of ancillary services to the credit card holders (such as waived resort fees, priority entry into night clubs, lounge access, and so on). The performance obligation related to loyalty credits is satisfied when or as the underlying goods or services have been provided and the loyalty credit has been retired (generally when the related redemption occurs and the free or discounted services

are provided to the loyalty customer), whereas the performance obligation or obligations related to the brand elements, other marketing services, and ancillary services are satisfied over time. FASB ASC 606-10-32-29 provides that "an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis." As a result, the sponsor would allocate the transaction price based on the relative stand-alone selling prices of the brand performance obligation, marketing-related services, ancillary services, and the goods or services expected to be provided upon the redemption of the loyalty credits by the loyalty customers.

6.6.80 Substantially all of the consideration in co-branded credit card agreements is variable and a vast majority of the payments are based on a successful use of the card by the card holder. Paragraphs 5–9 of FASB ASC 606-10-32 provide guidance on estimating variable consideration, and paragraphs 11–13 of FASB ASC 606-10-32 provide guidance on constraining estimates of variable consideration. FASB ASC 606-10-32-13 states that, "[a]n entity shall apply paragraph 606-10-55-65 to account for consideration in the form of a sales-based or usage-based royalty that is promised in exchange for a license of intellectual property."

6.6.81 As indicated in paragraph 6.6.77, the right granted by the sponsor to the financial institution to use its brand elements (that is, access to the customer list and use of the brand) as part of the co-branded credit card agreement qualifies as licensing of the sponsor's IP. FASB ASC 606-10-55-65A states the following in reference to determining whether the revenue recognition guidance in FASB ASC 606-10-55-65 is applicable to the IP in the arrangement:

The guidance for a sales-based or usage-based royalty in paragraph 606-10-55-65 applies when the royalty relates only to a license of intellectual property or when a license of intellectual property is the predominant item to which the royalty relates (for example, the license of intellectual property may be the predominant item to which the royalty relates when the entity has a reasonable expectation that the customer would ascribe significantly more value to the license than to the other goods or services to which the royalty relates).

6.6.82 As a result, the sponsor would apply the guidance in FASB ASC 606-10-55-65 with respect to IP if it concludes that the aspect of the agreement attributable to the licensing of the IP is the predominant item to which the royalty relates. This consideration would be based on the value of the IP element (that is, the combination of brand and customer list) to all other elements in the arrangement (which typically include other marketing-related services, ancillary services, and loyalty credits). Significant judgment may be required to determine whether a license of IP is the predominant item in an arrangement. Value ascribed by the co-brand partner to the license of IP (that is, the combination of brand and customer list) relative to the other services to which the consideration relates (other marketing-related services and ancillary services) may vary depending on provisions embedded in co-brand arrangements between a gaming entity and a financial institution. Based on facts and circumstances of individual co-brand arrangements, FinREC believes the gaming entity may determine that the licensing of IP is the predominant item if it represents the major part or substantially all of the value of the arrangement to which the consideration relates. If that conclusion is reached, then a sales-based or usage-based royalty revenue method would be applied for revenue recognition, as discussed in the following section.

IP Is Considered the Predominant Item in the Co-branded Card Arrangement

6.6.83 Once the transaction price is allocated between the performance obligations identified in the contract, then the gaming entity should follow the guidance in FASB ASC 606-10-55-65, which provides that

an entity should recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property only when (or as) the later of the following events occurs:

- a. The subsequent sale or usage occurs.
- b. The performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

6.6.84 In the co-branded arrangement, the promised services associated with the brand performance obligation are effectively provided to the financial institution continuously over the term of the arrangement, and royalties are generated each time the loyalty customer uses the co-branded credit card and the financial institution becomes responsible to pay the gaming entity. This corresponds with the timing of when the gaming entity issues or is obligated to issue the loyalty credits to the loyalty customer in connection with the co-branded agreement. As a result, the sponsor would consider usage of the co-branded credit card to determine the recognition of the sales-based and usage-based royalties. Therefore, consideration received in exchange for the brand performance obligation would be recognized as revenue as and when the loyalty program members use their co-branded credit cards to make purchases. As noted in paragraph 6.6.79, the allocated amount recorded for the loyalty credits is recognized as revenue when or as the underlying goods or services have been provided and the loyalty credit has been retired at a point in time (generally when the related redemption occurs and the free or discounted services are provided to the loyalty customer).

6.6.85 *Royalty Rates.* Co-branded credit card agreements generally call for a fixed royalty rate over the term of the agreement (that is, a fixed amount of consideration per loyalty credit issued to loyalty members as a result of their usage of a co-branded credit card). In this case, actual volume declines in the number of loyalty credits sold would be recognized as incurred because they would be reflective of the actual decline in the use of the IP. However, if the specified royalty rate declines over time, a sponsor would need to evaluate whether the decline reflects the value transferred to the financial institution (customer). If the value transferred to the customer as it relates to the brand performance obligation is deemed to be constant but the royalty rate declines, then the declining royalty rate does not reflect the value transferred to the customer and a sponsor may have to defer revenue related to the brand performance obligation to properly allocate the revenue to the contract performance period.

IP Is Not Considered the Predominant Item in the Co-branded Card Arrangement

6.6.86 If the sponsor concludes that the IP element (that is, the combination of brand and customer list) is not the predominant item in the co-branded arrangement, then at contract inception, the gaming entity should consider the guidance in paragraphs 5–9 of FASB ASC 606-10-32 on estimating variable consideration and the guidance in paragraphs 11–13 of FASB ASC 606-10-32

on constraining estimates of variable consideration. After considering variable consideration guidance, the gaming entity should recognize revenue using one of the methods described in paragraphs 16–21 of FASB ASC 606-10-55.

Customer "Bounties"

6.6.87 Often co-brand agreements will include provisions under which the financial institution will make a payment (bounty) to the sponsor for each co-branded credit card customer enrolling in a credit card agreement (previously defined as "holders"). Such contractually agreed-upon amounts may be paid in full at sign-up, or in multiple payments after a prescribed number or amount of transactions have been made on the card subsequent to its issuance.

6.6.88 These bounty structures may have the following general characteristics:

- a. A set rate to be paid by the financial institution to the sponsor for each enrollee (the bounty)
- b. A contractual number of loyalty credits to be deposited into a holder's account upon the holder's successful enrollment (sign-on credits)
- c. Limitations on the amount of loyalty credits that a sponsor can offer as an incentive to sign up for a co-branded credit card
- d. A structure in which the financial institution may pay for each incremental point above the sign-on credits subject to certain limitations
- e. A structure in which a financial institution will pay one amount for loyalty credits issued based on holder spending (spend rate), and a different amount will be paid for loyalty credits issued for promotions or holder sign-ups

6.6.89 If an agreement as described in paragraph 6.6.88 exists, a sponsor should assess whether the discounted rate paid to it as the bounty by a financial institution for the sign-on credits is equivalent to the stand-alone selling price of a loyalty credit.

6.6.90 FASB ASC 606-10-32-6 provides a list of common types of variable consideration that may occur in a contract with a customer. Specifically, FASB ASC 606-10-32-6 states

[t]he promised consideration also can vary if an entity's entitlement to the consideration is contingent on the occurrence or nonoccurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.

6.6.91 BC190 expands on this and broadly states "[t]he Boards noted that variable consideration can arise in any circumstance in which the consideration to which the entity will be entitled under the contract may vary."

6.6.92 FinREC believes that bounty payments represent variable consideration based on the determination that no amounts are due to the sponsor until a holder successfully obtains a co-branded credit card; accordingly, all consideration is variable until the occurrence of a future event (enrollment by the holder).

6.6.93 Paragraphs 39–40 of FASB ASC 606-10-32 provide for a scenario in which variable consideration is allocated entirely to one performance obligation. FASB ASC 606-10-32-39 states the following:

Variable consideration that is promised in a contract may be attributable to the entire contract or to a specific part of the contract, such as either of the following:

- a. One or more, but not all, performance obligations in the contract (for example, a bonus may be contingent on an entity transferring a promised good or service within a specified period of time)...

6.6.94 FASB ASC 606-10-32-40 further provides that

[a]n entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 606-10-25-14(b) if both of the following criteria are met:

- a. The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).
- b. Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 606-10-32-28 when considering all of the performance obligations and payment terms in the contract.

6.6.95 If the sponsor, as a result of the assessment made in paragraph 6.6.89, concludes that the amount it receives from the financial institution as a bounty results in a bounty rate per sign-on credit that is equivalent to the stand-alone selling price of a loyalty credit¹⁷ and that the discount from the spend rate is entirely due to the absence of the brand performance obligation being included in such activities, then FinREC believes allocating the variable consideration from bounty payments entirely to the sign-on credits performance obligation may best achieve the objective of allocating the transaction price set forth in FASB ASC 606-10-32-28 because the payment by the financial institution is not in exchange for access to the brand performance obligation (that is, the financial institution has access to market and exploit the brand performance obligation irrespective of whether there are any holders) and the terms of the variable payment relate to the sign-on credits.

6.6.96 If, however, the sponsor does not reach the conclusion set forth in the preceding paragraph, then FinREC believes allocating the variable consideration from bounty payments should be made on a relative stand-alone selling price basis between the sign-on credits and the brand performance obligation by determining the stand-alone selling price of these distinct performance obligations and allocating the transaction price in proportion to those stand-alone

¹⁷ The determination of the stand-alone selling price of a loyalty credit is addressed in paragraphs 6.6.09–6.6.49 in the section "Loyalty Credits and Other Discretionary Incentives (Excluding Status Benefits)."

selling prices in accordance with the guidance in paragraphs 28–41 of FASB ASC 606-10-32.

6.6.97 The following is an illustrative example of the application of paragraphs 6.6.87–6.6.96, assuming that the license is predominant in the arrangement. The actual application of FASB ASC 606 should be based on the facts and circumstances of an entity's specific situation.

Example 6-6-5

Assume the following:

- a. Sponsor has a co-branded credit card agreement (agreement) with Financial Institution under which Sponsor will grant 30,000 sign-on loyalty credits for every customer signing up for the card.
- b. Financial Institution will pay Sponsor a bounty of \$30 for each enrollee.
- c. Financial Institution will pay Sponsor \$0.0025 per loyalty credit for each loyalty credit deposited into a co-brand cardholder's account earned based on spending.
- d. Financial Institution will pay Sponsor \$0.001 per loyalty credit for each loyalty credit deposited into a co-brand cardholder's account earned from promotional activity unrelated to spending.
- e. Sponsor has previously determined that the difference between the \$0.0025 spend rate and the \$0.001 promotional rate is due to the marketing-related use of the brand and customer list that occurs when spending activity takes place.
- f. The agreement contains provisions limiting the number of promotional credits and the number of promotions annually.
- g. Sponsor has previously determined that the stand-alone selling price of a loyalty credit is \$0.001.

Sponsor assesses its bounty arrangement and determines its implicit bounty rate is \$0.001 per new cardholder ($\$30 \text{ bounty} \div 30,000 \text{ sign-on loyalty credits} = \0.001). Sponsor compares this rate to the stand-alone selling price of \$0.001 and notes they are equal. Because Sponsor (as noted in item (e) in the preceding list) has previously determined that the difference between the \$0.0025 spend rate and the \$0.001 promotional rate is due to the marketing-related use of the brand and customer list that occurs when spending activity takes place and that the derived bounty rate is substantially the same as the stand-alone selling price, Sponsor allocates the entire bounty received to the loyalty credit performance obligation.

Accounting for Management Contract Revenues, Including Costs Reimbursed by Managed Properties

This Accounting Implementation Issue Is Relevant for Application of FASB ASC 606 to Management Contract Revenue.

Overview

6.6.98 A gaming entity may provide casino management services without an intellectual property (IP) license (for example, to a third-party branded

casino—the managed property) and charge the managed property owner base and incentive management fees for those services and, in addition, be reimbursed for certain costs incurred on behalf of the managed property (for example, employee payroll). Alternatively, the gaming entity may also license IP in a bundle with a casino management services agreement and charge the managed property owner the fees previously described, as well as royalty fees, for both the management services and license of the IP. Based on the specific facts and circumstances, the fees charged by the gaming entity (for example, license royalty, base, and incentive fees) may be calculated on different revenue bases (for example, gross casino revenues, total revenues, or gross operating profit). In some circumstances, payments made by the gaming entity pursuant to casino management agreements are for expenses that would otherwise be incurred by the managed property. For example, the gaming entity may agree to employ staff for the benefit of the managed property or pay certain expenses for the benefit of the managed property, such as rent, utilities, or IT functions. The managed property typically reimburses the gaming entity for such expenses separately from any management fee payments, and the gaming entity may or may not receive additional compensation in the form of a service fee from the managed property in consideration of making such payments.

Step 1: Identify the Contract

Contract Combinations

6.6.99 A casino management arrangement with the managed property owner may include several agreements that are generally negotiated at the same time with the same counter-party. FASB ASC 606-10-25-9 states the following:

An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contract as a single contract if one of more of the following criteria are met:

- a. The contracts are negotiated as a package with a single commercial objective.
- b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
- c. The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

6.6.100 Although the specific facts and circumstances of a given transaction should be considered, FinREC believes that the ancillary agreements executed with a casino management agreement (for example, pre-opening or centralized services or license agreement) will generally meet the criteria in FASB ASC 606-10-25-9 and should be combined with the casino management agreement and accounted for as a single contract.

Scope Considerations

6.6.101 In customary casino management agreements, the gaming entity promises to provide services to guests (for example, casino games, room access, food and beverage services, housekeeping services, security, and so on)

and earns fees from the managed property owner for the services it provides. Prior to evaluating the contract in the context of FASB ASC 606, the gaming entity should evaluate the casino management agreement in order to determine whether the agreement represents a lease and, therefore, would be accounted for in accordance with FASB ASC 840 (or FASB ASC 842, once adopted) or the casino management agreement with the managed property legal entity results in the gaming entity being the primary beneficiary of a variable interest entity (VIE) based on the guidance within FASB ASC 810. If the gaming entity determines that the casino management agreement is not a lease and the casino management agreement does not result in the gaming entity being the primary beneficiary of a VIE, then the gaming entity should evaluate the accounting for the agreement in accordance with FASB ASC 606.

Principal Versus Agent Analysis for the Operation of the Managed Property's Business

6.6.102 Under FASB ASC 606, the gaming entity should consider whether it is acting as a principal or agent when providing goods or services to casino guests to determine whether its customer is the managed property owner (gaming entity is agent), or the casino guest (gaming entity is principal). A key factor in the determination of whether the gaming entity is a principal or an agent is whether the gaming entity controls the specified goods or services prior to the transfer to the casino customer both per the terms of the casino management agreement and in practice.

6.6.103 FASB ASC 606-10-55-37 states that "an entity is a principal if it controls the specified good or service before that good or service is transferred to a customer." FASB ASC 606-10-55-37 also states that "an entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf." Gaming operations are highly regulated and govern the ownership, control, and operation of specific gaming assets used for the provision of management services in a casino. Accordingly, the conclusion reached will be highly dependent on the gaming entity's specific facts and circumstances. The scope of this section addresses circumstances in which the gaming entity has concluded that it is acting in the capacity of an agent for purposes of operating the games and other revenue-generating activities of the Managed Property. See also paragraph 6.6.120 regarding employees and related services provided to the managed property owner.

Step 2: Identify the Performance Obligations

Identifying the Promises in a Casino Management Agreement

6.6.104 Within the context of a typical casino management agreement, several promises are made to the managed property owner that, in accordance with FASB ASC 606-10-25-14, should be analyzed to determine if they are distinct and, therefore, separate performance obligations within each casino management agreement. The following table describes a noncomprehensive list of some of the promised services that are often included in a management agreement and the method in which compensation to the gaming entity is often determined:

<i>Goods and Services Promised</i>	<i>Description of Goods and Services</i>	<i>Method to Determine Gaming Entity Compensation</i>
Gaming entity IP	License to use the gaming entity's brand name and related marks, including the gaming entity's loyalty program (brand IP or "brand IP license)	License royalty fee based on gross revenues of managed property
Casino management services	Management of casino property operations for the managed property owner based on the terms of the casino management agreement	Base and incentive fees determined on managed property performance (for example, revenues and operating profits)
Employees and related services	Provide employees and centralized accounting services	Reimbursement of costs incurred
Pre-opening services	Providing consultation services over the pre-opening period (pre-opening services or brand oversight, or both)	Fee-based
Ad-hoc services	Other ad-hoc services (for example, purchasing services)	Fee-based

6.6.105 Based on the specific facts and circumstances, the gaming entity should determine if any of the promises included within the casino management agreement are more indicative of a fulfillment activity of another promise versus a separate promise.

Identifying Whether the Promised Goods and Services Are Distinct

6.6.106 Once the gaming entity has identified the promised good or service, the gaming entity should then identify the associated performance obligation(s). In accordance with FASB ASC 606-10-25-14, a performance obligation is either of the following:

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

6.6.107 FASB ASC 606-10-25-15 further states the following:

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- a. Each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time.

- b. In accordance with paragraphs 606-10-25-31 through 25-32, the same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

6.6.108 The gaming entity should determine if the promises are distinct and should be accounted for as separate performance obligations. FASB ASC 606-10-25-19 explains that the following two criteria need to be met for a good or service to be distinct:

- a. The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct).
- b. The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (that is, the promise to transfer the good or service is distinct within the context of the contract).

6.6.109 To identify the distinct goods or services promised within the context of a typical casino management agreement, the gaming entity should first identify the promises that are capable of being distinct. For each of the promises identified, the gaming entity should typically then consider if the promise is separately identifiable within the context of the contract being evaluated.

6.6.110 The items promised to a managed property owner through a casino management agreement may vary based on the needs of the managed property owner, the local market, brand of casino, and so on. Likewise, the fee structure of a casino management agreement will vary, as well. Because services and fee structures vary from arrangement to arrangement, a careful review is needed to understand whether the services or bundle of services would be capable of being distinct.

6.6.111 FinREC believes if the gaming entity or its industry peers routinely sells any of the goods and services specifically outlined within the casino management agreement separately to other managed property owners, the promised goods and services are generally capable of being distinct in accordance with FASB ASC 606-10-25-19(a).

6.6.112 To determine the distinct services within a typical casino management agreement as defined in FASB ASC 606-10-25-19, the gaming entity should consider whether the promised goods and service(s) that are considered capable of being distinct also meet the criterion in FASB ASC 606-10-25-19(b) as being separately identifiable from other promises in the contract (that is, distinct within the context of the contract). As explained in FASB ASC 606-10-25-21, the gaming entity should consider whether the nature of its promise is to transfer each of the goods or services or whether the promise is to transfer a combined item (or items) to which the promised goods or services, or both, are inputs.

6.6.113 To aid a company performing its assessment of whether the promised goods or services within an arrangement are separately identifiable, FASB ASC 606-10-25-21 provides factors that indicate that two or more promises to transfer goods or services are not separately identifiable, noting that the list is not all inclusive.

Assessing Whether the Promises in a Casino Management Agreement Represent Separate Performance Obligations

6.6.114 *Brand IP license.* A brand IP license may be embedded in or executed separately (but simultaneously) with a casino management agreement. The gaming entity should consider whether the license is distinct from the casino management services. Casino management agreements are generally coterminous; if the management contract terminates, then the casino must be rebranded. Furthermore, the gaming industry has trended away from providing management services on a branded basis. The preceding facts notwithstanding, although gaming entities that provide both licensing and management services generally do not license their brands separately from providing services under a management agreement, there are circumstances in which gaming entities have separately licensed their brands without providing management services. Property owners generally have the option of selecting management services with or without licensing the gaming entity's brand. Similarly, a gaming entity also has the option of offering such casino management services both with and without licensing its brand IP.

6.6.115 To determine whether the brand IP license and the casino management services meet the criterion in FASB ASC 606-10-25-19(a) and, therefore, are capable of being distinct, a gaming entity should consider the guidance in FASB ASC 606-10-25-20.

6.6.116 As noted in paragraph 6.6.114, the property owner has significant discretion about whether it contracts to obtain management services with or without licensing the gaming entity's brand. Similarly, a gaming entity also has the option of offering casino management services with and without licensing its brand IP. Therefore, FinREC believes that the brand IP license is capable of being distinct pursuant to FASB ASC 606-10-25-19(a) because the licensee can benefit from the license either on its own or together with other resources that are readily available to the licensee.

6.6.117 To determine whether the brand IP license and the casino management services meet the criterion in FASB ASC 606-10-25-19(b) and are separately identifiable and, therefore, distinct within the context of the contract, a gaming entity should assess the following applicable factors from FASB ASC 606-10-25-21:

- a. Whether the gaming entity provides a significant service of integrating the casino management services and brand IP license into a bundle of goods or services that represent the combined output specified by the property owner. In other words, the gaming entity is using the goods or services as inputs to produce or deliver the combined output.
- b. Whether the casino management services and the brand IP license each significantly modify or customize the other.
- c. Whether the casino management services and brand IP license are highly interdependent or highly interrelated. In other words, the gaming entity must assess whether each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfill its promise by transferring each of the goods or services independently.

6.6.118 There are many facts and circumstances that a gaming entity will need to assess in determining whether the factors set forth in FASB ASC 606-10-25-21 are met. Following are examples (not intended to be an exhaustive list) in the gaming industry of such factors that might be considered in assessing FASB ASC 606-10-25-21:

- a. FASB ASC 606-10-25-21(a): The loyalty program of the gaming entity that the property owner benefits from is considered to be part of the brand IP license as noted in paragraph 6.6.104. Casino marketing programs often rely significantly on the loyalty program of the gaming entity. This is generally because a gaming entity providing casino management services cannot compel an end customer to provide personal information that allows the gaming entity to track the play by the end customer. Therefore, marketing efforts are often reliant on the data collected from customers enrolled in and presenting their loyalty cards when engaging in gaming activity. A property owner could significantly benefit from access to the loyalty program and, hence, the brand IP license, without acquiring the casino management services from the loyalty program operator (which is the gaming entity) such that the gaming entity is not integrating the casino management services and brand IP license to arrive at a combined output specified by the customer.
- b. FASB ASC 606-10-25-21(b): The brand IP license does not alter the casino management services, and the casino management services can be provided without the brand IP license and, therefore, do not change the brand IP or diminish the benefit provided to the property owner from receiving the casino management services
- c. FASB ASC 606-10-25-21(c): Similar to 21(b), the casino management services and brand IP license do not depend on each other and, therefore, are not highly interdependent or highly interrelated.

6.6.119 Based on the assessment in paragraph 6.6.118, FinREC believes that the brand IP license would typically be considered separately identifiable from the other promised goods or services under FASB ASC 606-10-25-19(b). However, because of the diverse nature of such casino management agreements, there may be circumstances in which a gaming entity may conclude that the brand IP is not a separate performance obligation. All relevant facts and circumstances should be considered.

6.6.120 *Employees and related services.* The gaming entity should assess whether the provision of employees and related services is separately identifiable from the casino management services. FinREC believes that the provision of employees and related services will generally not be considered separately identifiable from the casino management services because of the following:

- a. The employees perform the casino management services and, thus, there would be an integration of the promise to provide employees and related services and the casino management services into a combined output as described in FASB ASC 606-10-25-21(a).
- b. The employees are necessary to carry out the casino management services; thus, there is a high degree of interdependency between the promises to provide employees and related services and the casino management services, which indicates that the guidance in FASB ASC 606-10-25-21(c) is likely met.

6.6.121 *Casino management services.* In a typical casino management agreement, the overall nature of the promise is to arrange for the provision of services to casino guests on behalf of the managed property owner (for example casino services, hotel rooms, housekeeping, food and beverage, entertainment, and so on) over the agreement term. Often, the negotiated contractual promises include discrete management and operational functions, such as the employment of property employees, revenue management, centralized accounting services, and other. Additionally, Example 12A in paragraphs 157C–D of FASB ASC 606-10-55 clarifies that although a hotel manager's underlying activities will vary both within a day and day-to-day, a hotel manager is providing a daily management service that is distinct and substantially the same. FinREC believes Example 12A would apply equally to a gaming entity providing casino management services. FinREC believes that the preceding services are components of the casino management services and would not be considered separately identifiable because the gaming entity provides a significant service of integrating the services (the inputs) into the overall management service (the combined output) for which the managed property owner has contracted.

6.6.122 The gaming entity would then assess the nature of the promises under FASB ASC 606-10-25-14, specifically, whether the promises are a distinct good or service or whether the promises represent a series of distinct goods or services as described in FASB ASC 606-10-25-14(b). The casino management services would constitute a series of distinct services that represents a single performance obligation when the following occurs:

- a. The gaming entity concludes that the promise to transfer the casino management services is satisfied over time. Therefore, the casino management services meet the criterion of FASB ASC 606-10-25-15(a).
- b. The same measure of progress (a daily time-based increment) would be used to measure the gaming entity's progress toward complete satisfaction of the performance obligation to provide the daily casino management services. Therefore, the casino management services meet the criterion of FASB ASC 606-10-25-15(b).

6.6.123 The combination of the promises to provide the casino management services and the employees and related services are collectively referred to as the *casino management services series* throughout the rest of this section.

6.6.124 *Pre-opening services.* The gaming entity will need to use judgment to determine whether its activities prior to the opening of a property transfer a service to the customer that is distinct from the management promises. This assessment may vary based on the individual contract needs and the gaming entity's customary business practices. A key consideration in that assessment is whether the pre-opening services and casino management services series are interrelated and whether the gaming entity could fulfill its promise for one independently of the other. FinREC believes considerations that would indicate that these activities do not transfer a distinct service to the managed property owner during the pre-opening period may include the following:

- a. The services do not create or enhance an asset (that is, the casino) that the managed property owner controls as it is created or enhanced in a way that can be beneficial to the managed property owner separate and apart from casino management services.

- b. The managed property owner does not consume the benefits of pre-opening services separate from the gaming entity performing casino management services.
- c. The pre-opening services represent an element of preparing to provide casino management services that do not provide a benefit to the customer independently of the recurring services that will be provided to a customer.

6.6.125 If the gaming entity concludes that either the activities do not transfer a service to the managed property owner, or the service is not separately identifiable from the casino management services series, the gaming entity should bundle the pre-opening activities services with the casino management services series for the purpose of identifying and accounting for the performance obligation. If the gaming entity concludes that the activities do transfer a service to the managed property owner, and this service is separately identifiable and, therefore, distinct, the gaming entity should account for the service as a separate performance obligation.

6.6.126 *Ad-Hoc services.* Other discrete goods or services promised by the gaming entity may be separately identifiable from the casino management services series or other identified performance obligations. These discrete goods or services may be performance obligations specifically included in the management services contract, optional goods, or services listed in the contract, or may be negotiated at a later time. Based on the specific facts and circumstances, ad-hoc service promises may be separately identifiable when evaluated based on the principle and the factors in FASB ASC 606-10-25-21.

6.6.127 If the gaming entity concludes that such ad-hoc services are separately identifiable, then they should be treated as a separate performance obligation; otherwise, they should be combined into the casino management services series.

Step 3: Determining the Transaction Price

6.6.128 FASB ASC 606-10-32-2 states the following:

An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which a gaming entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

6.6.129 The gaming entity receives base and incentive fees for the services provided to the managed property owner. Additionally, the gaming entity typically charges several other fees to the managed property owner for costs it incurs in providing those services. The gaming entity should evaluate whether it is the principal or the agent prior to including any fees related to reimbursed costs in the estimate of the transaction price.

Significant Financing Component

6.6.130 On occasion, the casino management agreement may include up-front payments or extended payment terms, or both, for the associated fees (for example, a subordinated management fee). The gaming entity should evaluate

the payments in accordance with paragraphs 15–20 of FASB ASC 606-10-32 to determine if these payment terms are indicative that the arrangement contains a significant financing component. If the gaming entity concludes that there is a significant financing component, in accordance with FASB ASC 606-10-32-15, the gaming entity would adjust the promised amount of consideration such that the transaction price reflects the time value of money. The gaming entity should also evaluate the effect that the financing component might have on financial statement presentation.

Fixed Fees

6.6.131 At the inception of the casino management agreement, there may be certain fixed fees (for example, a pre-opening services fee) that might be included in the transaction price. Amounts that are fixed per the contract terms may, in fact, be variable if the managed property owner has a valid expectation arising from the gaming entity's customary business practices that it will provide a fee concession, or other facts and circumstances indicate that the gaming entity intends to provide a concession. For example, if the contract contains a fixed pre-opening fee, the gaming entity should consider whether it has a history of waiving all or a portion of that fee and, if so, would consider the fee variable for the purposes of estimating the transaction price. If the gaming entity determines that the fee is, in fact, variable, it should consider the guidance in paragraphs 11–13 of FASB ASC 606-10-32 on constraints on variable consideration in determining the amount to include within the transaction price at contract inception.

Variable Consideration

6.6.132 The casino management fees that are based on the managed property's revenues and profit are variable. Because casino management agreements typically do not outline specific activities that the gaming entity will perform (for example, a specified amount of labor hours at a rate per hour), the reimbursable fees are also variable because the amount is not known at the beginning of the contract, and the amount that the gaming entity will be entitled to changes based upon the requirements to fulfill the contractual promises each day. Therefore, because the majority of fees associated with a typical casino management agreement are variable consideration, the estimate of the transaction price associated with these fees (for example, base fees, incentive fees, and reimbursed fees) should be determined in accordance with the guidance on variable consideration and constraining estimates of variable consideration in paragraphs 5–13 of FASB ASC 606-10-32.

6.6.133 FASB ASC 606-10-50-14A provides a practical expedient that allows companies to not disclose the estimate of revenues related to variable fees that are allocated entirely to a wholly unsatisfied performance obligation or to a wholly unsatisfied promise to transfer a distinct good or service that forms part of a single performance obligation (a series) in accordance with FASB ASC 606-10-25-14(b), for which the criteria in ASC 606-10-32-40 have been met. As discussed in paragraphs 6.6.137–6.6.140, the criteria in FASB ASC 606-10-32-40 generally will be met if the fees based on the managed property's revenues or profits, or both, are consistent throughout the contract term. Therefore, any estimate of the transaction price associated with future services that will be provided under the contract would be allocated to wholly unperformed services within the series and would meet this disclosure practical expedient.

Accordingly, the gaming entity would not need to include an estimate of variable fees that will be earned in future periods in the transaction price.

Constraining Estimates of Variable Consideration

6.6.134 In accordance with FASB ASC 606-10-32-11, a gaming entity should include only amounts of variable consideration in the transaction price to the extent it is probable that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty associated with the variable consideration is subsequently resolved. This constraint would primarily apply to incentive fees, which vary based on casino performance over a defined period that may extend past the current period. Typically, other fees generated by the gaming entity are not subject to change based on future performance. However, the gaming entity would also need to consider any anticipated refunds or concessions it will provide on any fees generated to date.

6.6.135 As discussed in FASB ASC 606-10-32-12, determining the amount of variable consideration to include in the transaction price should consider both the likelihood and magnitude of a revenue reversal. FinREC believes that the following are factors that may exist in the gaming industry that could increase the likelihood or the magnitude of a revenue reversal (not intended to be an exhaustive list):

- a. Casino management agreements are typically long-term in nature. Although a gaming entity may have experience with similar contracts, in many cases, the experience is of little predictive value over the long term.
- b. The promised consideration related to the management obligation may be highly dependent on the specific market conditions and also may be influenced by factors outside of both the managed property owner's and the gaming entity's influence, such as economic, social, political, and natural forces.
- c. The promised consideration related to the casino management obligation is often highly dependent on the managed property owner's budget and other decisions, such as its willingness and ability to make capital improvements to the casino.
- d. The amount the gaming entity will earn generally will have a large number and broad range of possible outcomes.

6.6.136 Although casino management agreements are typically long-term in nature, they often include annual incentive fees that are independent of other years in the agreement. Therefore, gaming entities should consider the preceding factors both over the near term (that is, current year) and long term (that is, life of the contract) in assessing the likelihood or magnitude of a potential revenue reversal.

Updating the Estimate of Transaction Price at Each Reporting Period

6.6.137 In accordance with FASB ASC 606-10-32-14, at each reporting date, the gaming entity should update its estimate of the transaction price associated with the base and incentive fees as well as fees for the casino management and operational functions in accordance with the example in paragraphs 221–225 of FASB ASC 606-10-55.

6.6.138 The gaming entity should assess whether it can conclude that the expected amount of the incentive fees due under the contract terms can be

included in the transaction price. In making this assessment, it must be probable that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty associated with the variable consideration is subsequently resolved. Often, specific considerations are included in the terms of such management contracts that a gaming entity must assess in reaching its conclusion. For instance, if the property has seasonality, when it earns a significant profit in the first part of the year that historically gets fully or partially eliminated by unprofitability in the last six months of the year, the gaming entity would most likely not include the entire billable incentive fee in the current period transaction price even if the gaming entity had the ability to bill and collect incentive fees in the first part of the year because those amounts are subject to subsequent adjustment.

6.6.139 At the end of each period, based on the specific facts and circumstances, the gaming entity should include in the transaction price the amount of the base fees for the casino management and operational functions for which it is probable that a significant reversal in the cumulative amount of revenue recognized would not occur.

6.6.140 The gaming entity does not need to estimate the future variable fees that will be earned under the remaining contract because these amounts will neither be recognized nor disclosed, assuming the provisions of FASB ASC 606-10-32-40 are met.

Step 4: Allocating the Transaction Price

Allocation Objective

6.6.141 FASB ASC 606-10-32-28 states that "the objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service in a series) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer."

Allocation of the Variable Fees Within the Agreement to the Separate Performance Obligations or to the Distinct Goods or Services, or Both, That Form Part of a Single Performance Obligation

6.6.142 In consideration of the allocation objective, FASB ASC 606-10-32-40 states the following:

An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a single performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 606-10-25-14(b) if both of the following criteria are met:

- a. The terms of the variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and
- b. Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 606-10-32-38 when considering all the performance obligations and payment terms in the contract.

6.6.143 When allocating the variable fee streams to the separate performance obligations, the gaming entity should consider whether the fee specifically relates to the entity's efforts to satisfy its promises under the contract or the outcome of providing the distinct service (or bundle of services), or both. Consistent with Example 12A of FASB ASC 606-10-55-157E, FinREC believes that as the terms of the variable consideration relate specifically to the gaming entity's efforts to transfer each distinct daily service, the allocation of the monthly base and incentive fee (or change in the incentive fee) to the daily services provided during the month they are billable (subject to the constraint) would meet the allocation objective, assuming that the fees as a percentage of the managed property's revenue and profit are consistent throughout the contract term. Similarly, as the cost reimbursements are commensurate with the entity's efforts to fulfill the promise(s) each day, then the allocation objective would be met by allocating the fees to the daily services performed as the gaming entity incurs the associated costs.

6.6.144 FASB/IASB TRG Agenda Ref 39, *Application of the Series Provision and Allocation of Variable Consideration*, Example C, discusses a situation in which a manager has entered into a 20-year agreement to manage properties on the behalf of the customer. Specifically, in paragraph 46 of TRG Agenda Ref 39, it is noted that the staff thinks the base monthly fees could meet the allocation objective for each month because there is a consistent measure throughout the contract period that reflects the value to the customer each month (the percent of monthly sales). Similarly, if the cost reimbursements are commensurate with the gaming entity's efforts to fulfill the promise each day, then the allocation objective for those variable fees could also be met. Paragraph 46 of TRG Agenda Ref 39 noted that the allocation objective could also be met for the incentive fee if it reflects the value delivered to the customer for the annual period (reflected by the profits earned) and is reasonable compared to the incentive fees that could be earned in other periods. However, paragraph 44 of TRG Agenda Ref 39 indicates that if the pricing decreases during the contract term (for example, the percent of monthly sales is higher in earlier years and lower in later years), additional evaluation of the reason for the pricing decline would be necessary to conclude that the allocation objective is met (for example, if the pricing is based on market terms or linked to either the entity's costs to fulfill the obligation or value delivered to the customer).

Allocation of Discounts Among the Performance Obligations

6.6.145 A gaming entity may provide a discount for certain of the fees in the agreement in order to incentivize the managed property owner to enter into the management agreement. FASB ASC 606-10-32-37 indicates that an entity (the gaming entity) should allocate the discount entirely to one or more, but not all, performance obligations if all the following criteria are met:

- a. The gaming entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a standalone basis.
- b. The gaming entity also regularly sells on a standalone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the standalone selling prices of the goods or services in each bundle.
- c. The discount attributable to each bundle of goods or services described in (b) is substantially the same as the discount in the contract, and an analysis of the goods or services in each bundle

provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.

6.6.146 In the case of a management agreement in which the gaming entity accounts for the brand IP license and casino management services as separate performance obligations and one or more of the fees is discounted from the standalone selling price, the gaming entity should consider whether it meets the criteria in FASB ASC 606-10-32-37 to allocate the discount entirely to one or more performance obligations. If it determines it does not, the gaming entity should allocate the transaction price based on relative standalone selling prices.

Allocation of Fixed Fees

6.6.147 Once the variable consideration has been linked to specific performance obligations, the gaming entity should evaluate any fixed fees to determine the appropriate allocation of these fees to the separate performance obligations in accordance with paragraphs 28–38 of FASB ASC 606-10-32. In accordance with FASB ASC 606-10-32-29, the allocation should be performed based on the relative standalone selling price of the associated services within the contract. FASB ASC 606-10-32-32 explains that the best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in a similar circumstance to similar customers.

Step 5: Recognizing Revenues When (or as) the Gaming Entity Satisfies the Performance Obligation

License Performance Obligation

6.6.148 The gaming entity should assess whether the brand IP performance obligation is promised in exchange for a sales-based or usage-based royalty in accordance with FASB ASC 606-10-55-65. FinREC believes that if the gaming entity has determined that there is a separate brand IP performance obligation and the compensation to be received by a gaming entity for such brand IP License is as described in paragraph 6.6.104, the fee for the brand IP license will qualify for the sales-based or usage-based royalty guidance in FASB ASC 606-10-55-65.

6.6.149 Depending on the conclusion reached in Step 2 as described in paragraphs 6.6.114–6.6.119, the transaction price allocated to a separate brand IP performance obligation in accordance with FASB ASC 606-10-55-65 (if the brand IP license has been determined to be a separate performance obligation) would be recognized when the later of the following events occurs:

- a. The subsequent sales or usage occur.
- b. The performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

6.6.150 If, however, the gaming entity has concluded that the brand IP license is a component of the casino management services series, (which is not generally expected to be the case; see paragraph 6.6.119), the gaming entity identifies the predominant good or service of the combined performance obligation, assesses the best measure of progress for satisfying its performance obligation, and recognizes the revenues allocated to the distinct services provided

to the managed property owner on that basis. FinREC believes that the provision of casino management services will generally be the predominant item, in which case, the sales- or usage-based royalties exception of FASB ASC 606-10-55-65 would not apply to the royalty for the brand IP license. However, assuming the provisions of FASB ASC 606-10-32-40 are met, the monthly variable royalty fees will be allocated to each distinct period of service and, therefore, recognized as revenue in the period the fees are generated consistent with the revenue or profit-based variable fee for management services.

Management Services

6.6.151 As concluded in paragraphs 6.6.121–6.6.122, the casino management services is a series of distinct services performed over time and with a time-based measure of progress. Therefore, the gaming entity would typically recognize the revenue allocated to the management services (including cost reimbursements) as revenue when both of the following exist:

- a. The fee has been included in the estimate of the transaction price.
- b. The distinct services to which the transaction price has been allocated have been provided.

Pre-Opening Services and Other Ad-Hoc Performance Obligations

6.6.152 The gaming entity should evaluate the pre-opening services and the remaining ad-hoc services in the contract (if applicable) to determine the appropriate revenue recognition for these services. Considerations might include the following:

- a. Does control transfer at a point in time or over time as noted in FASB ASC 606-10-25-27?
- b. If the control transfers over time, what is the appropriate measure of progress towards completion as noted in paragraphs 31–37 of FASB ASC 606-10-25 and paragraphs 16–21 of FASB ASC 606-10-55?

Accounts Receivable and Contract Assets

6.6.153 If the gaming entity has an unconditional right to collect the consideration under the contract terms (consideration is billable per the contract terms) in accordance with FASB ASC 606-10-45-1, the amount should be presented separately as an account receivable.

6.6.154 If the gaming entity has performed by providing the distinct services to which it has allocated a portion of the estimate of the transaction price before the associated amount has been paid or an account receivable has been recognized (see preceding discussion) in accordance with FASB ASC 606-10-45-3, the gaming entity should present the associated portion of the transaction price as a contract asset. An example of where this may occur is when the gaming entity has recognized a portion of the incentive fee but does not have an unconditional right to payment for this amount until a managed property owner's minimum return threshold is met for the annual incentive fee period. FinREC believes that the contract asset would be recognized ahead of the gaming entity having an enforceable right to payment at that specific point in time, if the gaming entity has concluded it is probable that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty is resolved, as previously described in Step 3.

6.6.155 Gaming entities with large loyalty programs may enter into agreements with a co-branded credit card partner in which loyalty credits and other consideration (for example, discounted gaming, room upgrades, resort fee waivers, loyalty lounge access, and branding and marketing services) are sold to a financial institution. The credits are then issued to the financial institution's credit card customers, who are also gaming loyalty members, as they make purchases on their co-branded credit cards. In these co-branded contracts, certain services, principally advertising and branding, including access to the gaming entity's customer list, are used directly by the financial institution. The services sold to the financial institution help its credit card business obtain new and more profitable customers and promote increased spending on credit cards. Co-branded credit cards are often more profitable to financial institutions than a typical credit card portfolio and, as such, they are willing to pay the gaming entity for access to its customers and the brand of the gaming entity. During the multi-year term of these contracts, the financial institution is granted continual access to the customer list.

Other Related Topics

Accounting for Jackpot Insurance Premiums and Recoveries

This Accounting Implementation Issue Clarifies the Accounting for Jackpot Insurance Premiums and Recoveries.

6.7.01 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.¹⁸

6.7.02 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.

6.7.03 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.

¹⁸ Promotional payouts not associated with gaming activities are not included in the discussion in this section.

6.7.04 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.

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

6.7.06 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.

6.7.07 Contracts with gaming customers for 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.¹⁹

6.7.08 The transaction price in a wagering transaction, in accordance with FASB ASC 606-10-32-2 and 32-3, is the amount of consideration to which a gaming entity expects to be entitled in exchange for transferring promised goods or services to a customer, which includes "consideration payable to a customer" in the transaction.²⁰ Premiums paid to a third party, are not "consideration payable to a customer," and are costs incurred outside the scope of FASB ASC 606, are therefore accounted for in accordance with other applicable guidance.

6.7.09 Jackpot insurance represents a risk mitigation to the gaming entity and allows the casino to market higher jackpots in order to entice more customers. Such premium cost is recorded with other insurance premium costs typically in general and administrative expenses. FinREC believes that such costs represent neither a cost to obtain nor a cost to fulfill a contract with a customer and are therefore outside the guidance in FASB ASC 340-40.

6.7.10 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.

6.7.11 FinREC believes that recoveries under jackpot insurance policies should be accounted for as other income consistent with the accounting for insurance recoveries in involuntary conversions under FASB ASC 610-30 and are not revenue from contracts with customers under FASB ASC 606.

¹⁹ Refer to "Definitions: The Terms *Win* and *Gross Gaming Revenue*" in paragraphs 6.6.01–6.6.21, regarding the guidance for accounting of gaming transactions as the difference between gaming wins and losses.

²⁰ See footnote 19.

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

Accounting for Gaming Chips and Tokens

This Accounting Implementation Issue Clarifies the Accounting for Gaming Chips and Tokens

6.7.13 The liability for chips and tokens that are not under the control of the gaming entity (also known as the chip or token float), represent a financial obligation to a customer and should be accounted for in accordance with FASB ASC 924-405-25-1, which is commonly referred to in the industry as breakage. In accordance with FASB ASC 924-405-35-1, "the chip liability shall be adjusted periodically to reflect an estimate of chips that will never be redeemed (for example, chips that have been lost, taken as souvenirs, and so on)."

6.7.14 FinREC believes that the offsetting entry for the reduction in the chips and tokens liability should be recorded as a component of net gaming revenue. In accordance with FASB ASC 606-10-50-4, material breakage income should be separately disclosed (either in the statement of comprehensive income or the notes to the financial statements) from revenue recognized from contracts with customers.

6.7.15 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 gaming entity determines it is legally released from the redemption requirement and a liability no longer exists, FinREC believes that breakage income would be recognized for the dollar amount of chips and tokens that were not redeemed and had not previously been accounted for in accordance with the preceding paragraph.

Net Gaming Revenue

This Accounting Implementation Issue Clarifies the Accounting for Adjustments for Cash Sales Incentives and Change in Progressive Jackpot Liabilities.

6.7.16 FinREC believes the adjustments for cash sales incentives and the change in progressive jackpot liabilities to arrive at net gaming revenue represent consideration payable to a customer and, therefore, should reduce the transaction price, and be accounted for as contra-revenue, in accordance with paragraphs 25–27 of FASB ASC 606-10-32.

Gaming Operator's Accounting for Base Progressive and Incremental Progressive Jackpot Amounts

This Accounting Implementation Issue Clarifies the Accounting by Gaming Operators for Base Progressive and Incremental Progressive Jackpot Amounts.

Background

6.7.17 Jackpots can generally be categorized among four basic types: single machine progressive jackpots, single machine non-progressive 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 non-progressive jackpots and the base progressive jackpots are referred to as *base jackpots*.

6.7.18 In most gaming jurisdictions, gaming entities are not required to award any non-progressive jackpot until the jackpot is won, 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 machines.

6.7.19 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.

6.7.20 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, WAP 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.

6.7.21 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

6.7.22 FASB ASC 924-405-25-2 states that "an entity shall accrue a liability at the time the entity has the obligation to pay the jackpot (or a portion

thereof as applicable) regardless of the manner of payment." Therefore, an entity will not accrue a base jackpot if payments of the jackpot can be avoided.

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

Promotional Allowances

This Accounting Implementation Issue Clarifies the Accounting for Promotional Allowances.

6.7.24 Promotional allowances (complimentaries or "comps") represent goods and services that a casino gives to customers as an inducement to gamble at that establishment. Examples are rooms, food, beverages, entertainment, and parking.

6.7.25 FinREC believes that the amount of revenue from contracts with customers recognized and reported on the income statement cannot exceed the amount of the transaction price accounted for and determined in accordance with FASB ASC 606. Additionally, FASB ASC 606-10-32-28 instructs an entity to allocate the transaction price earned from a contract with its customer to the performance obligations in the contract. Accordingly, FinREC believes historical financial statement presentations which present (1) gross for goods and services that a gaming entity gives to customers as an inducement to gamble and (2) an offsetting reduction to gross revenues for promotional allowances or complimentaries to yield net revenues are not in accordance with FASB ASC 606.

Participation and Similar Arrangements

This Accounting Implementation Issue Clarifies the Accounting for Participation and Similar Arrangements

Background

6.7.26 Gaming entities periodically enter into participation arrangements with gaming suppliers. In participation arrangements, the title to the slot machine is typically retained by an owner/seller, 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 either by sharing the win or by the gaming entity paying a fixed percentage of coin in or a flat fee to the owner/seller.

6.7.27 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.

Analysis of Lease Criteria for Various Arrangements²¹

6.7.28 The primary accounting guidance related to participation and similar arrangements is described in FASB ASC 840, *Leases* (or FASB ASC 842, *Leases*, subsequent to adoption).

6.7.29 To determine whether the arrangement is accounted for as a lease under FASB ASC 840 (or FASB ASC 842, subsequent to adoption), an analysis of the specific terms of each contract governing a participation, third-party license, or WAP arrangement²² is typically performed by each party to the arrangement using the guidance explained in FASB ASC 840-10-15.

Income Statement Presentation²³

6.7.30 Participation arrangements are typically leases because the arrangements will generally meet the criteria set forth in FASB ASC 840-10-15-6 and, therefore, will contain a lease because such arrangements allow a gaming entity to control a specified slot machine. Gaming entities usually report these arrangements as operating leases because none of the financing or capital lease criteria set forth in FASB ASC 840-10-25-1 have been met. The casino pays a percentage of the win of participating slot machines to slot machine lessors. Usually, the win is recorded as revenue within the income statement, and the participating fees paid to slot machine lessors is recorded as an expense.

6.7.31 Third- party license arrangements are typically not leases.

6.7.32 In accordance with the guidance in paragraphs 36–40 of FASB ASC 606-10-55, the gaming entity should evaluate whether they are acting as a principal or agent in providing the licensed games to its customers.

6.7.33 FASB ASC 606-10-55-36 states that "When another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods and services to be provided by the other party (that is, the entity is an agent)."

6.7.34 FASB ASC 606-10-55-36A states:

To determine the nature of its promise (as described in paragraph 606-10-55-36), the entity should:

- a. Identify the specified goods or services to be provided to the customer...
- b. Assess whether it controls (as described in paragraph 606-10-25-25) each specified good or service before that good or service is transferred to the customer."

²¹ ASU No. 2016-02, *Leases (Topic 842)*, was issued in February 2016, and supersedes existing guidance in FASB ASC 840, *Leases*, and is generally effective beginning after December 15, 2018, for public entities. Although the guidance for determining whether an arrangement is a lease has not changed significantly, the general accounting for leases as operating and capital (or finance under the new standard) leases will change under the new standard for leases, principally because all operating leases will now be recognized on the balance sheet.

²² Wide area progressive arrangements are discussed in the section "Income Statement Presentation of Wide Area Progressive Operators' Fees Received From Gaming Entities" in paragraphs 6.7.38–6.7.68.

²³ As noted in footnote 21, current lease accounting will be superseded beginning in 2018. Accordingly, the specific guidance here around leases will change; however, such guidance will continue to preclude treatment of lease fees as a contra revenue.

6.7.35 FASB ASC 606-10-55-39 contains a list of indicators that demonstrate that an entity controls the specified good or service before it is transferred to the customer, and is, therefore, a principal. The indicators in FASB ASC 606-10-55-39 are not intended to be an exhaustive list.

6.7.36 Although the fees paid pursuant to these arrangements are often characterized as "participation fees," which, imply a potential principal versus agent arrangement, FinREC believes for a typical third-party license arrangement related to a copyrighted game and its underlying intellectual property, the assessment of whether the gaming entity controls the revenue-producing arrangement, along with any analysis of the principal versus agent considerations in paragraphs 38–40 of FASB ASC 606-10-55, indicates that the gaming entity is the principal in the arrangement and is simply contracting for the right to use the copyrighted game in its operations. The owner/seller does not control the service being offered. The gaming entity licensing the copyrighted game

- a. has complete control and responsibility for determining if and when the specified regulatory approved game and related odds are provided in its casino to its customers under such agreement.
- b. is solely responsible and at risk for payouts to winning patrons, that is, obligations arising from the outcome of wagers made by customers participating in the specified game. Conversely, the owner/seller does not participate in the wager and is not at risk for payouts to winning patrons.
- c. has total discretion for "pricing" associated with the wagers (that is, controls decisions over incentives and marketing offered to induce customers to wager on the game).
- d. manages, operates, conducts, and otherwise controls the operation of, location, and results and outcome of the game (within the restraints dictated by the games rules and the regulator, who has approved the use of such games in the gaming jurisdiction). Conversely, the owner/seller has no such control or input into the operation of the game after it is licensed for use and has no ability to offer or conduct the game himself or herself without obtaining a gaming license to conduct gaming operations within the regulatory jurisdiction.

6.7.37 FinREC believes all of these considerations listed in paragraph 6.7.36 are the responsibility of the gaming entity licensed to conduct gaming by a regulator. In accordance with FASB ASC 606-10-55-37B, fees paid pursuant to such arrangements would be reported as an expense, rather than as a reduction to the revenue earned by the entity in its gaming operations.

Income Statement Presentation of Wide Area Progressive Operators' Fees Received from Gaming Entities

This Accounting Implementation Issue Clarifies the Income Statement Presentation of Wide Area Progressive Operators' Fees Received from Gaming Entities

Background

6.7.38 Gaming entities periodically enter into participation arrangements with gaming suppliers. In participation arrangements, the title to the slot machine is typically retained by an owner/seller, 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.

6.7.39 Operators provide a wide area progressive (WAP) Offering to Gaming Entities. The Operator enters into a contract with the Gaming Entity to provide the Gaming Entity with WAP gaming machines, which are connected to a WAP system. The WAP system links all WAP gaming machines located throughout a jurisdiction within various gaming entities that are unrelated to the WAP operator.

6.7.40 As Patrons play the WAP gaming machines located across the multiple gaming entities, a percentage of their play contributes to the system-wide WAP Jackpot award. The system-wide WAP Jackpot continues to increase through Patron play until the point at which a Patron hits (wins) the WAP Jackpot. Hundreds or thousands of Patrons (this is a conservative estimate) play a WAP system before one Patron hits the WAP Jackpot. Once the WAP Jackpot hits, it resets and the cycle begins again.

6.7.41 The WAP Offering typically increases gaming machine play by giving Patrons the opportunity to win a significantly larger jackpot than on non-linked gaming machines.

6.7.42 From the perspective of a gaming entity, WAP arrangements function in a manner similar to participation arrangements but are not participation arrangements. In WAP arrangements, the fees paid by the gaming entity to the WAP Operator primarily relate to the services provided to maintain and operate a wide area progressive system, including the WAP Jackpot.

Analysis of Lease Criteria for Various Arrangements

6.7.43 The primary accounting guidance relating to participation and similar arrangements is described in FASB ASC 840 (or FASB ASC 842, subsequent to its adoption).

6.7.44 To determine whether the arrangement is accounted for as a lease under FASB ASC 840 (or FASB ASC 842, subsequent to its adoption), an analysis of the specific terms of each contract governing a participation, third-party license, or WAP arrangement is typically performed by each party to the arrangement using the guidance explained in FASB ASC 840-10-15.

Gaming Entity—Fees to WAP Operator

6.7.45 For WAP arrangements determined to not include a lease,²⁴ FinREC believes that the Gaming Entity would report fees paid to the WAP Operator pursuant to a WAP arrangement as an expense consistent with payments for goods and services received from a vendor. For example, consider the following:

²⁴ In situations in which the WAP arrangement is determined to be a lease, the Gaming Entity would follow the guidance in FASB ASC 840 (or FASB ASC 842, *Leases*, subsequent to its adoption) which generally requires fees paid under the arrangement to be classified as expenses in the income statement when the arrangement is considered an operating lease.

Assumptions

Gross amount wagered by patrons	\$100
Amount paid out by gaming entities to patrons	(87)
<hr/> Win from patrons	<hr/> 13
Operator's share of gross amount wagered (per contract)	6.0%
Operator's contribution to WAP jackpot	2.0%
Income statement impact:	
Revenue	\$13
Contra Revenue	
Gaming Revenue, net	\$13
<hr/> Gaming Expense	<hr/> 6
<hr/> Operating Income	<hr/> \$7

WAP Operator—Fees from Gaming Entity

6.7.46 For WAP arrangements determined to not include a lease,²⁵ the guidance in FASB ASC 606 should be applied. The following provides an analysis of such arrangements under FASB ASC 606.

Step 1: Identify the Contract with a Customer

6.7.47 FASB ASC 606-10-25-1 provides criteria that must be met in order to have a contract with a customer under the guidance in FASB ASC 606. FASB ASC 606-10-25-2 notes that "a contract is an agreement between two or more parties that creates enforceable rights and obligations." The FASB ASC Glossary defines *customer* as 'a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.' Further, FASB ASC 606-10-32-25 indicates that a customer includes other parties that purchase the entity's goods or services from the customer, which is the Gaming Entity, for purposes of a WAP arrangement.

6.7.48 In assessing the applicability of FASB ASC 606, the WAP Operator will typically have a written agreement with the Gaming Entity that includes explicit requirement for the WAP Operator to pay the WAP Jackpot directly to the winning WAP Jackpot Patron.

Step 2: Identify the Performance Obligations in the Contract

6.7.49 Typically, the WAP Operator provides an offering to Gaming Entities that requires the WAP Operator to provide the Gaming Entity with WAP gaming machines, which are connected to a WAP system. The WAP system

²⁵ If a wide area progressive arrangement is determined to contain a lease, the entity would need to separate the nonlease components of the arrangement from the lease components and account for the nonlease components in accordance with FASB ASC 606 and the lease components in accordance with FASB ASC 840 for lessors.

links all WAP gaming machines located within various unrelated gaming entities throughout a jurisdiction. Because these WAP gaming machines are linked, the payout amounts that can be won by the Patron are increased significantly. The WAP Operator also manages all monies received for funding WAP Jackpot awards and is contractually responsible for funding and paying the WAP Jackpot awards to the Patrons who win the WAP Jackpots.

6.7.50 A WAP Operator should assess the following different potential performance obligations in the WAP arrangement:

- a. Provide and set up functioning WAP gaming machines and related WAP meters and signage, connected to the WAP system
- b. Provide the WAP Offering inclusive of related services such as monitoring the WAP system, maintaining the functioning of the WAP system, and other services ensuring proper functioning of the system with the WAP gaming machines, and the obligation (either by regulation and agreement with the Gaming Entity) to pay the WAP Jackpot awards to the Patrons who win the WAP Jackpots

6.7.51 The WAP Operator does not provide Gaming Entities with WAP gaming machines independent of the WAP Offering and vice versa. A Gaming Entity enters into an arrangement for the WAP gaming machines and the WAP Offering, which includes the requirement by the WAP Operator to pay the WAP Jackpot, on a combined basis. Accordingly, a WAP Operator should assess whether the potential performance obligations are distinct and therefore separate performance obligations under FASB ASC 606.

6.7.52 FASB ASC 606-10-25-19 indicates that a good or service... is distinct if both of the following criteria are met:

- a. The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct).
- b. The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (that is, the good or service is distinct within the context of the contract).

6.7.53 FinREC believes that the WAP gaming machines and the WAP Offering do not meet the criteria in FASB ASC 606-10-25-19(b), and would not be distinct within the context of the contract, as the WAP gaming machines and the WAP Offering are highly interdependent and interrelated. Therefore, FinREC believes there is one distinct performance obligation within the arrangement.

6.7.54 *Series of distinct goods or services.* As discussed in FASB ASC 606-10-25-14, a performance obligation is either a good or service that is distinct, or a series of distinct services that are substantially the same and have the same pattern of transfer to the customer as described in FASB ASC 606-10-25-15.

6.7.55 Paragraph 14 of FASB/IASB TRG Agenda Ref 39, *Application of the Series Provision and Allocation of Variable Consideration*, in addressing Issue 1 ("In order to apply the series provision, how should entities consider whether the performance obligation consists of distinct goods or services that are substantially the same?"), states that "in order to be considered a series, there must be more than one good or service that is distinct and each distinct good or service must also be substantially the same."

6.7.56 FinREC believes the promise to stand ready to provide the WAP Offering each day represents a series of distinct services which is the WAP Operator's promise to provide daily access to the WAP Offering over a period of time, and not a specified amount of services or access.²⁶ Although the underlying activities associated with the WAP Offering will vary both within a day and from day to day, FinREC believes that the WAP Offering is accessed over time and that the customer simultaneously receives and consumes the benefit from the WAP Operator's performance of providing WAP access (including other related activities). Each day of access to the WAP Offering is distinct and has substantially the same pattern of transfer to the customer²⁷ and therefore should be accounted for as a single performance obligation in accordance with paragraphs 14–15 of FASB ASC 606-10-25.

6.7.57 FinREC believes that the promise to stand ready to provide daily access to the WAP Offering is a series of distinct services that represents a single performance obligation when the following occur:

- a. The WAP Operator concludes that the promise to provide daily access to the WAP Offering is a performance obligation satisfied over time because the gaming entity simultaneously receives and consumes the benefits provided as the service is performed. Therefore, FinREC believes the WAP Offering meets the criterion of FASB ASC 606-10-25-15(a).
- b. The same measure of progress (a daily, time-based increment) would be used to measure the WAP Operator's progress toward complete satisfaction of the performance obligation to provide the daily right to access the WAP Offering. Therefore, FinREC believes the WAP Offering meets the criterion of FASB ASC 606-10-25-15(b).

Step 3: Determine the Transaction Price

6.7.58 The transaction price should be determined in accordance with the guidance in paragraphs 2–27 of FASB ASC 606-10-32.

6.7.59 The WAP Operator receives fees from the Gaming Entity for providing the WAP Offering based upon the amount of coin-in from the Patrons. The WAP Operator determines the amount of fees received from the Gaming Entity that will be allocated to the WAP Jackpot. When that WAP Jackpot is won by a Patron, the WAP Operator is responsible for such payment.

6.7.60 FASB ASC 606-10-32-3 explains that when determining the transaction price of a contract with a customer, an entity should consider the effects of consideration payable to a customer.

6.7.61 FASB ASC 606 requires an entity to account for consideration payable to a customer as a reduction of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. Specifically, FASB ASC 606-10-32-25 states the following:

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that

²⁶ The WAP Offering is similar to obligations as described in TRG Issue Paper No. 16, "Stand-Ready Performance Obligations."

²⁷ As described in FASB ASC 606-10-25-27 and FASB ASC 606-10-25-31.

purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity. An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. ...

6.7.62 FinREC believes that the WAP Operator's costs incurred for WAP Jackpot awards to the Patron would be accounted for as consideration payable to the customer, because the payment made to a customer's customer (the Gaming Entity's customer) is part of the WAP Operator's contractual agreement with the Gaming Entity. FinREC believes that the payment from the WAP Operator to the Patron is not in exchange for a distinct good or service that the Patron transfers to the Operator.

6.7.63 FinREC believes that the transaction price ultimately recognized as revenue by the Operator generally includes fees earned from Gaming Entities reduced by costs incurred for WAP Jackpot awards. For example, consider the following:

Assumptions

Gross amount wagered by patrons	\$100
Amount paid out by gaming entities to patrons	(87)
Win from patrons	13
<hr/>	
Operator's share of gross amount wagered (per contract)	6.0%
Operator's contribution to WAP jackpot	2.0%
Income statement impact:	
Revenue	\$6
Contra Revenue	(2)
Total revenue	\$4
<hr/>	
Cost of sales ²⁸	
Gross margin	\$4

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

6.7.64 FASB ASC 606-10-32-29 indicates that an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis in accordance with paragraphs 31–35 of

²⁸ A WAP Operator will incur other expenses to operate a WAP and the related infrastructure such as depreciation, payroll, IT costs, and so on, all of which would be classified as cost of sales if such a financial statement line item is presented, or otherwise within operating expenses if cost of sales is not presented as a financial statement line item. Such costs should not be presented as reductions to revenue. However, such expenses have not been included in this example for simplicity.

FASB ASC 606-10-32, except as specified in paragraphs 36–38 (for allocating discounts) and paragraphs 39–41 (for allocating consideration that includes variable amounts).

6.7.65 *Allocation of the variable fees within the agreement to the separate performance obligations and to the distinct good(s) or services that form part of a single performance obligation.* As noted in FASB ASC 606-10-32-40, a WAP Operator should allocate variable fees entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation if both of the following criteria are met:

- a. The terms of the variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).
- b. The allocation of the variable amount to the performance obligation or the distinct good or services is consistent with the allocation objective when considering all the performance obligations and payment terms in the contract.

6.7.66 If the WAP Operator has concluded the performance obligation is a series of daily services for which the uncertainty regarding the consideration is resolved on a daily basis, FinREC believes the allocation of the monthly variable Royalty and System Assessment Fees to the daily services provided during the month they are billable would meet the allocation objective in FASB ASC 606-10-32-28 for each month.

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

6.7.67 In addition, as noted in FASB ASC 606-10-55-18, as a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date, the entity may recognize revenue in the amount to which the entity has a right to invoice. As a result, the WAP Operator will recognize revenues as and when the underlying sales (for example, gross gaming revenues) occur. This issue was also addressed in FASB/IASB TRG Agenda Ref 39.

6.7.68 FinREC believes that a WAP Operator should recognize the amount of the transaction price allocated to the distinct daily service each day as the service is performed.

Recognition of the WAP Operator's Liability for Base Progressive and Incremental Progressive Jackpot Amounts

This Accounting Implementation Issue Clarifies the Accounting for the Timing of Recognition of the WAP Operator's Liability for Base Progressive and Incremental Progressive Jackpot Amounts

Background

6.7.69 See paragraphs 6.7.38–6.7.42 of the section "Income Statement Presentation of Wide Area Progressive Operators' Fees Received from Gaming Entities" for background discussion on WAP offerings.

WAP Operator's Liability for Base Progressive and Incremental Progressive Jackpot Amounts

6.7.70 FASB ASC 924-405-25-2 states that "an entity shall accrue a liability at the time the entity has the obligation to pay the jackpot (or a portion thereof as applicable) regardless of the manner of payment."

6.7.71 FASB ASC 606 requires that an entity account for consideration payable to a customer as a reduction of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. Specifically, FASB ASC 606-10-32-25 states the following:

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity. An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. ...

6.7.72 FASB ASC 606-10-32-27 states the following:

Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognize the reduction of revenue when (or as) the later of either of the following events occurs:

- a.* The entity recognizes revenue for the transfer of the related goods or services to the customer.
- b.* The entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

6.7.73 WAP jackpots are the responsibility of the WAP Operator, not the Gaming Entity. In accordance with the discussion at the March and July 2015 FASB/IASB TRG meetings, FinREC believes that the payment of a WAP jackpot by the WAP Operator to the Patron would be accounted for as consideration payable to the customer, because the payment made to a customer's customer (the Gaming Entity's customer) is part of the WAP Operator's contractual agreement with the Gaming Entity. FinREC believes that the payment from the WAP Operator to the Patron is not in exchange for a distinct good or service that the Patron transfers to the WAP Operator.

6.7.74 FinREC believes the guidance in FASB ASC 606-10-32-27 should be applied in conjunction with FASB ASC 924-405-25-2 when determining the timing for recognition of the WAP Operator's liability for base progressive and incremental progressive jackpot amounts. FinREC believes that the guidance in FASB ASC 924-405-25-2 indicates that a liability should be recognized when a promise as described in FASB ASC 606-10-32-27 has been made by a WAP Operator to pay the consideration. Accordingly, FinREC believes that the guidance in FASB ASC 924-405-25-2 and FASB ASC 606-10-32-27 are consistent in terms of the timing of the liability recording in that the consideration payable to a customer in a WAP arrangement should be recognized when a promise to pay the consideration exists as defined in FASB ASC 924-405-25-2.

Accounting for Racetrack Fees

This Accounting Implementation Issue Clarifies the Accounting for Racetrack Fees.

Background

6.7.75 In pari-mutuel betting, the horse racing bettors are wagering against each other, rather than placing a bet against the race track. For this reason, the payouts on a single wager could range anywhere from less than the actual amount wagered to astronomical amounts.

6.7.76 Some gaming entities (off-track entities), as a component of their operations, receive simulcasts of horse and other races from various racing tracks (referred to hereafter as "host entities") and accept betting on the simulcast races. Such simulcasts of horse and other races are typically called the *race book*.

6.7.77 When the host entity hosts a race event, that entity typically establishes a pari-mutuel wagering pool (the pool)²⁹ and broadcasts a simulcast signal related to such event in order that off-track entities accepting wagers for inclusion in the pool can comply with regulations under their state's regulatory environment. The provision of this simulcast signal is separately managed by the host entity, which will generally procure such broadcast services from a third party. The procurement of such broadcast services and the resulting payments by a host entity to the broadcast services provider are outside the scope of this guide. The host entity publishes its racing calendar well in advance of racing events being held, and off-track entities will negotiate to participate in the pari-mutuel pools at both parties' discretion, often under industry standard terms; accordingly, if such standard terms are incorporated, there is not a high degree of marketing to off-track entities to participate in the pari-mutuel pools a host entity may establish. If the parties contract to participate in the pool, the off-track entity is then granted the ability to accept wagers for inclusion in the pool. In connection with this arrangement, a number of different fees and services are involved.

6.7.78 Once a pool is established, the wagers accepted by the off-track entity on simulcasts are often aggregated by a third-party clearinghouse entity (clearinghouse). This "aggregation" is generally not of a physical flow of funds, but rather it is a bookkeeping service the clearinghouse provides, enabling a more efficient settlement process among all entities participating in the pool. All bets are electronically commingled as part of the pari-mutuel activity to facilitate a settlement process (generally monthly) amongst those participating entities. Payments made to a third-party clearinghouse for providing such services are outside the scope of this guide. At the completion of a race event

²⁹ The term *pool* includes reference to the actual cash wagers, which may be electronically commingled, as well as to the individual bettors who participate in that wagering pool. See paragraph 6.7.75, which indicates that the effect of pari-mutuel wagering is that one is not wagering against the host entity, as would take place under fixed-odds wagering, but rather is wagering against the other bettors in the wagering pool. For illustrative and discussion purposes, this guide simplistically describes there being a single pool connected to a single race event. In practice, there are various forms of wagers that can be made on a single race or on multiple races. Each form of wager has its own pool associated with it. The purpose and functioning of each pool is similar as described herein and the existence of multiple pools is not expected to be significant to the analysis and conclusions a host entity or off-track entity would arrive at.

(or at the conclusion of a number of races, which could be over a longer period, such as a month), the settlement process takes place with all gaming entities participating in the various pari-mutuel pools in which the clearinghouse (which could be the host entity or a third party) will provide for a settlement mechanism (that is, certain entities will forward funds to the clearinghouse and vice versa to settle all winning wagers and net amounts to be retained by each entity).

6.7.79 A separate third-party entity called the totalizator will act as a record keeper of the pool and will provide aggregated real-time data, determining the closing odds for each race and for the entrants in the particular race being wagered on through aggregation of the total amounts wagered and the nature of those wagers. There are contractual agreements between the host entity and the clearinghouse and the host entity and the totalizator that are often uniform across the industry that set forth the amount that the third-party entities will receive for managing the pool funds and providing services. Such amounts may be paid directly by the gaming entity or from the pool, but the mechanism for payment does not affect the conclusions in this guide.

6.7.80 The host entity receives a commission for the wagers it has brought to the pool. It does not collect anything else when a bettor loses, nor does it pay additional amounts (from its funds) when a bettor wins. The total combined amount for commissions and taxes allowed (fees) to be taken from the pool is usually governed by the laws and regulations of the state where the race event occurs.

6.7.81 Off-track entities that take pari-mutuel bets on simulcast races will ultimately retain a net amount (consisting of the fees less amounts paid to the host entity and to the off-track entity's tax authority [see paragraph 6.7.85 for both]) for the wagers it has brought into the pool. The percentage range for this amount depends on the racetrack and type of wager accepted and the associated state regulations, and it may be the subject of ongoing negotiations driven by the host entity, depending on the specific facts and circumstances.

6.7.82 The clearinghouse manages all payments between the administrative participants (the host entity and off-track entities that need to settle with their customers) in the pool. This forwarding of funds occurs through a linked system where all bets are electronically commingled in the pari-mutuel pool. The clearinghouse provides the settlement services as described in paragraph 6.7.78.

6.7.83 The host entity may opt to not use a third-party clearinghouse to manage the flow of funds, including providing payment services to the off-track entities. In such cases, the host entity is acting as the clearinghouse for the pool and provides settlement services. Another scenario that may occur is that all participants make net settlements on a monthly basis to all pool participants; however, for the purposes of this guide, the accounting conclusion is not dependent on whether proceeds are settled net or gross and whether a clearinghouse is or is not used. Regardless of whether a third-party clearinghouse is used, the host entity provides such settlement services, or all parties settle on a gross or net basis over a longer period of time, the physical flow of funds should not affect an entity's conclusions about whether it should present revenue on a gross or a net basis.

6.7.84 At the conclusion of a race, all bettors are paid through the host and off-track entities from the pool funds based on closing odds of the applicable

race.³⁰ The host and off-track entities will receive their respective fees from the pool (plus or minus any adjustments of the fees between the host entity and the off-track entity specified in their agreement) and do not retain any portion (other than their fees) of the gross amount wagered (referred to within the industry as "handle").

6.7.85 Off-track entities either operate a race book as part of gaming operations or the race book can be operated by another racetrack entity. In either case, the entity is generally required by statute to provide a live simulcast of horse and other races from the host entity as a statutory condition to accepting wagers for inclusion in the pool associated with each such simulcast race. These wagers on live simulcast races accepted by the off-track entity are commingled in the pool. Related to the fees collected, the off-track entities involved in such activities will have certain payments or adjustments made in the net settlement process, such as

- a. track fees (typically simulcast fees), which represent fees the host entity receives for providing the race signal to off-track entities. Providing the race signal is considered part of the administrative services provided by the host entity. Participating off-track entities are generally required by statute to provide a live simulcast in order to offer bettors the ability to participate in the intrastate or interstate pari-mutuel wagering pool for a race event. These track fees may be paid either directly by the off-track entity to the host entity or through the settlement process described in paragraph 6.7.78.
- b. pari-mutuel taxes. These represent amounts paid by the host or off-track entity to the applicable regulatory entity based on the statutes in each participating jurisdiction.
- c. revenue splits (and similar off-track entity commission fee arrangements with the host entity). These are arrangements allowed by certain states in which the net commission received by an off-track entity is split with the host entity. In some cases, an intermediary entity (similar to the clearinghouse) may assist with the facilitation of activities between the off-track entity and the host entity and may also receive a portion of the commission paid by the pool related to the transactions it facilitates for the off-track entity.

6.7.86 The host entity typically provides the following directly to the off-track entity, which further passes such rights along to its customers:

- a. A simulcast signal, as required by the regulator to be licensed to operate the off-track entity
- b. Right to accept wagering for inclusion in the pool for the race held by the host entity

6.7.87 The off-track entity typically provides access to participate in the wagering pool and a facility (either physical or online) where wagers in the pool can be placed, as well as where the event may be viewed in real time through a simulcast to bettors wagering at the off-track entity facility.

³⁰ If a winning gaming customer placed his or her wager at an off-track entity, this off-track entity will pay any winnings to the customer. The funds to make such payments to a customer are remitted or paid to the host entity and off-track entities through the settlement process noted.

Principal Versus Agent Considerations

6.7.88 In accordance with the guidance in paragraphs 36–40 of FASB ASC 606-10-55-36, the host or off-track entities should evaluate whether they are acting as a principal or agent in providing access to the pool.

6.7.89 FASB ASC 606-10-55-36 states that

[w]hen another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods and services to be provided by the other party (that is, the entity is an agent).

6.7.90 FASB ASC 606-10-55-36A states that

[t]o determine the nature of its promise (as described in paragraph 606-10-55-36), the entity should:

- a. Identify the specified goods or services to be provided to the customer...
- b. Assess whether it controls (as described in paragraph 606-10-25-25) each specified good or service before that good or service is transferred to the customer.

6.7.91 A gaming entity should first evaluate the substance of the arrangements. It should assess whether, under its specific facts and circumstances, it controls the goods or services and acts as a principal as required by FASB ASC 606-10-55-36. In addition, FASB ASC 606-10-55-39 contains a list of indicators that an entity controls the specified good or service before it is transferred to the customer, and, is therefore a principal. The indicators in FASB ASC 606-10-55-39 are not intended to be an exhaustive list.

Classification of Wagers Received From Bettors and Winnings Paid to Bettors

6.7.92 Although not identified in FASB ASC 606-10-55-39 as an indicator of control, the fact that neither the host entity nor the off-track entity has any risk associated with the wager³¹ itself and, accordingly, has fixed economics at the inception of the wager further illustrates how the design of the pool and its activities, established by regulation, are intended to put control over the odds and outcome of the pool in the hands of those wagering, not the host entity or the off-track entity. The host and off-track entities are in effect offering the bettor the ability to wager within the pool against the other pool participants. The two types of entities are effectively the paying entities on behalf³² of the pool and its participants (that is, the host and off-track entities merely arrange

³¹ In some states, such as Nevada, if for some reason a wager is appropriately accepted by an off-track entity but is not transmitted properly, resulting in the wager not being included in the interstate common pari-mutuel pool, the off-track entity is, by regulation, responsible to any winning wagers meeting this condition such that the off-track entity would be required to pay the winning wager in accordance with official results (final payout odds on the winner) at the track out of its own resources. Although a potential risk to the entity, it is not part of the design of the wagering system and would not normally be expected to occur except in situations in which an off-track entity failed to follow appropriate operating procedures to ensure all wagers are properly included in the interstate common pari-mutuel pool.

³² This presumes that all such wagers or bets are successfully transmitted to the track by the system operator.

for a bettor's access to the pool as opposed to funding any payout of the pool with their own resources). For providing this access and facilitating the placement of such wagers, each entity is allowed to retain a predetermined percentage of the total wagers made in the pool (at the entity's location or online) as its commission for providing the services.

6.7.93 An assessment of the factors identified in FASB ASC 606-10-55-39 support the view that both the host entity and the off-track entities are acting as agents on behalf of the pool with respect to wagers with bettors. The host and off-track entities are not able to affect or control the odds³³ of various wagers because the actual odds are determined at closing cutoff prior to the race event as a function of the wagering activity (amount and nature of wagers) in total after deducting fees.³⁴ In addition, neither entity has inventory risk (in this case, the risk of pool funds) because the funds placed into the pool are distributed in accordance with statute and paid out based on the odds that are effectively determined by the choices of the pool wagering participants rather than any choice or action of either the host or off-track entity.

6.7.94 Based on the factors described in paragraph 6.7.93, FinREC believes that both the host and off-track entities provide the service being offered (access to the pool) but do not control the outcomes or the odds within that pool (as noted, those are determined by the pool participant wagers), for which these entities receive a commission from the pool. In the simplest terms, any entity (whether host or off-track) engaging with the pool receives a commission from the proceeds of wagers that that entity brought to the pool. Accordingly, FinREC believes that the amounts presented by the host and off-track entities related to the receipt of wagers and payments to winners should be presented on a net basis consistent with all gaming transactions.³⁵

Determination of Performance Obligations by an Off-track Entity

6.7.95 As described in paragraph 6.7.94 both the Host and Off-track Entities merely provide the service being offered, which is access to the Pool. Bettors at an Off-track Entity are generally gambling on a racing event being simulcast, and those bettors are not paying to watch the race as evidenced by customers "sitting out" certain races and not placing wagers on them.

6.7.96 As described in item (a) of paragraph 6.7.86, the off-track entity (in addition to contracting with the host entity) is required by statute to simulcast the event in order to accept wagering to participate in a pool. Therefore, access to the pool and the simulcast can only be obtained through the host entity as a bundled pair, and the host entity cannot provide pool access without the simulcast. An off-track entity accepting wagers in the pool has no alternative but to

³³ Some entities may routinely offer complimentary (or "comps") or other permissible benefits to customers, such as are provided in entity point-based loyalty programs. In such cases, the entity is effectively giving the customer additional benefits that indirectly affect the odds for such customer. The existence of such items does not change the assessment noted herein. This section does not address point-based loyalty programs. Point-based loyalty programs are addressed in the section "Loyalty Credits and Other Discretionary Incentives (Excluding Status Benefits)."

³⁴ Most states provide for a minimum payout on winning wagers regardless of whether there are sufficient funds in the pool to cover the minimum. Accordingly, in those limited situations in which sufficient funds may not exist, commissions will be reduced or limited and negative breakage results. Conversely, rounding differences may exist on payouts resulting in positive breakage increasing the commission paid. Unredeemed expired winning tickets are recognized as revenue in most states and subject to gaming taxation rather than as escheatable items.

³⁵ The definition of *win* and the presentation of amounts retained from wagering activities by a gaming entity are addressed in paragraphs 6.6.01–6.6.08.

provide (and therefore acquire) the simulcast of the race—it is required to do so as a condition of accepting wagers in the pool for a race event; it cannot provide wagering access separate from the simulcast. Therefore, FinREC believes that the provision of the live simulcast is not distinct pursuant to FASB ASC 606-10-25-19 and should be combined with access as the sole distinct performance obligation.

Classification of Track Fees Paid by the Off-track Entity (Determination of the Transaction Price by the Off-track Entity)

6.7.97 In accordance with FASB ASC 606-10-55-38 and paragraph 6.7.94, the transaction price to the host entity and to the off-track entity should exclude the amounts collected and remitted to the pari-mutuel pool and should be presented on a net basis; that is, the transaction price is equal to the commission retained from the pool by the host or off-track entity for arranging access by bettors to the pool.

6.7.98 The host entity receives an additional amount from the off-track entity to cover administrative services including the provision of the simulcast. Such fees are referred to in this guide as "track fees." Track fees may be determined as a fixed-dollar fee per day or based on a percentage of wagers if the off-track entity's state gaming commission or applicable racing commission has given its approval for the host entity to share in pari-mutuel pool commissions received by the off-track entity.

6.7.99 In assessing the nature of track fees, an off-track entity must determine whether such fees should be deducted from its commission for purposes of determining the transaction price or whether such fees are more appropriately presented as an expense, with the commission being reported at a gross amount. This decision about whether the off-track entity is acting as an agent on behalf of the host entity or as a principal will be based on the facts and circumstances of each off-track entity's contracts.

6.7.100 An off-track entity should evaluate the guidance in paragraphs 36–39 of FASB ASC 606-10-55 to determine whether it is a principal or agent in each contract with a host entity. FinREC believes the determination of whether an off-track entity is a principal or agent will be based on the specific facts and circumstances of each contractual arrangement.

6.7.101 FASB ASC 606-10-55-37 states the following:

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. However, an entity does not necessarily control a specified good or service if the entity obtains legal title to that good only momentarily before legal title is transferred to the customer. An entity that is principal may satisfy its performance obligation to provide the specified good or service itself or may engage another party (for example, a subcontractor) to satisfy some or all of the performance obligation on its behalf.

6.7.102 FASB ASC 606-10-55-39 provides indicators that an off-track entity should consider in determining whether it is acting as a principal or agent for the arrangement with the host entity. FASB ASC 606-10-55-39 states the following:

Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal [see paragraph 606-10-55-37]) include, but are not limited to, the following:

- a. The entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (for example, primary responsibility for the good or service meeting customer specifications). If the entity is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the entity's behalf.
- b. The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return). For example, if the entity obtains, or commits to obtain, the specified good or service before obtaining a contract with a customer, that may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer.
- c. The entity has discretion in establishing the price for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.

Classification by an Off-track Entity of Revenue Splits

6.7.103 In certain jurisdictions, a host entity may be able to charge an off-track entity a "revenue split" (as described in paragraph 6.7.85c), which is determined as a percentage of the amount of wagers an off-track entity takes in on a simulcast race. Because there is no substantive difference between a revenue split and a track fee (that is, one could be increased and the other decreased resulting in the same net effect), FinREC believes that the off-track entity would assess whether it is a principal or agent in the same manner for the revenue split as it would for track fees, as discussed in paragraphs 6.7.100–6.7.102.

Classification by a Host Entity or Off-track Entity for Pari-mutuel Taxes that Are Paid to the Regulator

6.7.104 FASB ASC 606-10-32-2 states that the transaction price excludes "amounts collected on behalf of third parties (for example, some sales taxes)." A gaming entity will also need to assess on a jurisdictional basis whether the guidance in FASB ASC 606-10-32-2A is applicable to its facts and circumstances. FASB ASC 606-10-32-2A states

[a]n 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 shall be excluded from the scope of the election.

6.7.105 Taxes on gaming transactions are generally imposed on a licensed gaming entity by the government or a regulatory body and are generally considered to be the responsibility of the licensed entity rather than the gaming customer. In the case of pari-mutuel wagering, the tax is often imposed as a stated percentage of the total amount wagered by bettors, rather than on the net winnings to the gaming entity as is the case with typical gaming taxes. Although the pari-mutuel wagering tax is often a stated percentage of the total amount wagered, state laws differ on the form and method of determining such taxes. An assessment should be made to determine whether such tax is effectively a tax to the host entity or off-track entity or a tax to the customers wagering in the pool even though the host or off-track entity may have responsibility for remitting taxes to the taxing authority.

6.7.106 FinREC believes that the presentation of pari-mutuel taxes by the host or off-track entity (as applicable) will be based on the assessment of the facts and circumstances of the numerous state and local regulations set forth by taxing authorities.

Disclosures—Contracts With Customers

This Accounting Implementation Issue Is Relevant to Accounting for Disclosure Requirements Under FASB ASC 606-10-50.

6.7.107 The guidance provided in this section addresses the new annual or adoption-year interim disclosure requirements under FASB ASC 606-10-50 for public entities. Gaming companies that are neither a public business entity nor 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 may elect not to provide certain of the disclosures required of public entities. These differences are described further in each of the sections that follow.

Disaggregation of Revenue

6.7.108 As discussed in BC335 of FASB ASU No. 2014-09, the intention of the disaggregation of revenue disclosure as outlined in FASB ASC 606-10-50-5 is to provide users of the financial statements with additional insights into the composition of a company's revenues that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. This may be most effectively achieved by providing disaggregated disclosures based on risk profile. Companies in the gaming industry may wish to consider whether the categories set forth in items (a)–(c) in the following list (which are not intended to be comprehensive) are the appropriate level of disaggregation necessary to meet the disclosure objectives set forth in paragraphs 5–6 of FASB ASC 606-10-50. A gaming entity may need to assess whether disaggregation should be made at a level lower than the primary revenue activities or the categories set forth in items (a)–(c) in the following list. For example, a gaming entity may only generate revenues and cash flows from gaming and food and beverage services and therefore may also need to assess whether revenue should be disaggregated based on the type of gaming activity (such as table games, slot machines, sports book, and so on) or similar areas as necessary to meet the disclosure objectives. For each of the disaggregation categories, gaming entities should consider whether the disclosure would be meaningful

or useful to financial statement users based on the nature of the entity's business, as well as whether such level of detail is already frequently disclosed or discussed either internally or externally. A gaming entity's disaggregation disclosures may be aligned with its segment disclosures (for example, the gaming entity may determine segments based on geography and also determine that economic factors affecting the nature, amount, timing, and uncertainty of revenues and cash flows are closely aligned with the geography in which those revenues and cash flows are earned); however, if segments are disclosed differently, then FASB ASC 606-10-50-6 requires that an entity disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment, if the entity applies FASB ASC 280, *Segment Reporting*.

- a. *Geographic region.* For gaming companies that have significant operations in various regions across the United States and outside of the United States, disaggregation by geographic region may be appropriate because the nature, amount, timing, and uncertainty of revenues and cash flows is dependent on both domestic and international priorities and budgets, which may differ. Furthermore, performance and collection risk on international programs is generally more significant than on domestic programs. Because priorities and risk can also vary significantly by country depending on geopolitical and economic factors specific to those countries, disaggregating revenue solely by U.S. and international may not be as meaningful as disaggregating by geographic region. Other gaming entities may determine that the best method of disaggregating by geographic region may be through a destination versus regional disclosure because properties in those categories tend to exhibit similar economics.
- b. *Revenue type.* In accordance with SEC *Codification of Staff Accounting Bulletins* topic 11(L), "Income Statement Presentation Of Casino-Hotels," gaming companies report significant sources of revenues on the face of the income statement by revenue type, such as gaming, food and beverages, rooms, entertainment, and other. A revenue type is generally considered significant if the revenue type accounts for 10 percent or more of total revenues. FinREC believes disclosure by revenue type would generally be expected for each geographic region identified to be disclosed in accordance with (a).
- c. *Managing properties for third parties.* To the extent that a gaming entity has significant revenues from managing properties for third parties in addition to revenues generated at properties owned, separate disclosure of such revenues would also be expected.

6.7.109 Refer to example 6-7-1 for an illustrative example of the disaggregation of revenue disclosure, which incorporates the considerations set forth in paragraph 6.7.108.

6.7.110 As required by FASB ASC 606-10-50-3, a disaggregation of revenue should be presented for all periods for which an income statement is presented.

6.7.111 FASB ASC 606-10-50-7 indicates that the quantitative disaggregation disclosure guidance in paragraphs 5–6 of FASB ASC 606-10-50 and paragraphs 89–91 of FASB ASC 606-10-55 is not required for entities that are

neither a public business entity nor 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. However, if an entity that is neither a public business entity nor 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 elects not to provide those disclosures, it must provide, at a minimum, revenue disaggregated according to the timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred to customers over time) and qualitative information about how economic factors (such as type of customer, geographical location of customers, and type of contract) affect the nature, amount, timing, and uncertainty of revenue and cash flows.

Disclosures About Performance Obligations

6.7.112 In addition to the aforementioned disclosures related to the disaggregation of revenues, a gaming entity will also have policy and qualitative disclosures necessary to help a user understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. A gaming entity should assess each of its disaggregated revenue streams and performance obligations to identify the level at which disclosures set forth in this paragraph should be made to meet the disclosure objectives required in FASB ASC 606-10-50-1. A gaming entity should assess which of the policy and qualitative disclosures are necessary to provide sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Once a gaming entity determines the most appropriate level of disclosure, the gaming entity should determine whether any or all of the following disclosures are necessary:

- a. The nature of goods and services provided (FASB ASC 606-10-50-12(c))
- b. A description that allows a reader of the financial statements to understand the timing and satisfaction of performance obligations (FASB ASC 606-10-50-9)
- c. How a gaming entity determined whether a promised good or service was a performance obligation, including any significant judgments and estimates made during that assessment (FASB ASC 606-10-50-12)
 - i. Any changes in such judgments and estimates, including any judgments and estimates included in reaching the conclusions in (cii) to (cvii), which follow (FASB ASC 606-10-50-12). Such judgments and estimates will likely include the determination of the stand-alone selling prices of the performance obligations
 - ii. The timing of satisfaction of the performance obligations (FASB ASC 606-10-50-12a)
 - iii. The payment terms associated with performance obligations (FASB ASC 606-10-50-12b)
 - iv. Obligations for returns, refunds, and other similar obligations (FASB ASC 606-10-50-12d), including whether there

- are any such provisions recorded associated with variable consideration
- v. Types of warranties and related obligations if any exist (FASB ASC 606-10-50-12e)
 - vi. Disclosure indicating when cash receipt generally occurs and how this relates to the general timing of recognition
 - vii. A description of how transaction price is allocated among performance obligations if there is more than one performance obligation in a contract with a customer (FASB ASC 606-10-50-20c)
 - viii. Explanation of when the gaming entity expects to recognize the aggregate transaction price allocated to remaining performance obligations either on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations or by using qualitative information (FASB ASC 606-10-50-13b)

6.7.113 As discussed in paragraph 6.6.03 of the section "Definitions: The Terms Win and Gross Gaming Revenue," the "transaction price" in a gaming transaction is deemed to be the net amount won from or lost to the customer for the wager, resulting in a transaction price that is positive, zero, or negative. Accordingly, the transaction price for a gaming transaction is the difference between gaming wins and losses, not the total amount wagered.

6.7.114 Paragraph 6.6.06 explains that combining of individual bets at a table or device, as noted previously, is allowed per FASB ASC 606-10-10-4, which indicates that

as a practical expedient, an entity may apply this guidance to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts (or performance obligations) within that portfolio.

6.7.115 A gaming entity's revenue policy disclosures should articulate such accounting for gaming transactions. See example 6-7-3 for an illustration of how a gaming entity might disclose basic accounting policy information.

Contract and Related Balances

6.7.116 Gaming companies typically have receivables from contracts with customers for marker balances related to gaming by a customer using credit extended to the customer by the casino and for amounts related to a customer's hotel room stay³⁶ at the company's properties. Liabilities of gaming entities related to revenue contracts are typically related to advanced deposits, unpaid

³⁶ Hotel receivables represent legal claims the entity has against the customer related to (1) completed hotel and food and beverage contracts that have not settled at period end through cash receipt, credit card processing, or similar settlement and (2) contracts in process for which the entity has satisfied some performance obligations and has a legal claim against the customer for the amounts associated with the delivery and completion of those performance obligations. An entity will typically report and disclose these items on a combined basis because a hotel stay usually lasts for less than a week and the settlement of the receivables occurs shortly thereafter, generally within a week after the stay, through credit card settlements.

wagers, and contract liabilities. Advanced deposits typically consist of customer safekeeping, front money, and rooms and convention space. Unpaid wagers generally consist of outstanding ticket-in, ticket-out (TITO) tickets; outstanding chip liability; and race and sports unpaid and futures. Contract liabilities are generally related to loyalty program obligations.

6.7.117 Presentation of a contract as a contract asset or a contract liability was discussed at the October 2014 FASB/IASB TRG meeting. Paragraph 12 of TRG Agenda Ref. No. 11, *October 2014 Meeting—Summary of Issues Discussed and Next Steps*, discusses how an entity should determine the presentation of a contract that contains multiple performance obligations:

TRG members generally agreed that a contract is presented as either a contract asset or a contract liability (but not both) depending on the relationship between the entity's performance and the customer's payment. That is, the contract asset or liability is determined at the contract level and not at the performance obligation level.

6.7.118 To address the requirement to disclose the opening and closing balances of these receivables, contract assets, and contract liabilities in accordance with FASB ASC 606-10-50-8(a) and provide an explanation of the significant changes in the contract asset and contract liability balances in the reporting period in accordance with FASB ASC 606-10-50-10, companies may consider disclosing a rollforward of the contract balances for the reporting period. Alternatively, companies may choose to disclose the opening and closing balances in a narrative or tabular format with enhanced narrative around the significant drivers of the changes in the balances.

6.7.119 To the extent that a gaming company chooses to present a tabular rollforward presentation of the contract balances, in order to meet the requirement to disclose revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period in accordance with FASB ASC 606-10-50-8(b), a gaming company should either separately disclose such amount or, in such tabular presentation, separately break out revenue (reductions to the contract balance) into two pieces: (a) from amounts included in the beginning contract liability and (b) amounts recognized from additions within the period. Refer to example 6-7-2 for an illustrative example of such a rollforward presentation for disclosure purposes.

6.7.120 The disclosure requirements outlined in paragraphs 8(a)–8(b) and 10 of FASB ASC 606-10-50 relate to contract balances and changes in those balances. Such disclosure would include a qualitative description in general of the receipt of cash versus the recognition of revenue and how such matters affect the contract asset and contract liability balances. Similarly, such qualitative information should be provided regarding the timing of receipt of cash versus recognition of revenue by revenue type. The disclosures would likely align with the rollforward information discussed in paragraph 6.7.119 and would capture year-to-date information (that is, using the periods on the comparative balance sheet), although an entity may provide supplemental quarterly information.

6.7.121 FASB ASC 606-10-50-11 indicates that the disclosure requirements in paragraphs 8–10 and 12A of FASB ASC 606-10-50 related to contract balances and certain changes affecting revenue, timing of the satisfaction of performance obligations, and explanation of the significant changes in the

contract asset and liability balances during the reporting period are not required for entities that are neither a public business entity nor 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. However, if an entity that is neither a public business entity nor 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 elects not to provide these disclosures, the entity should follow the guidance in FASB ASC 606-10-50-8(a), which requires the disclosure of the opening and closing balances of receivables, contract assets, and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed.

Other Required Disclosures

6.7.122 Because the majority of gaming transactions occur where the receipt of cash and the recognition of revenue are closely aligned, and often the remaining performance obligations of a gaming entity will relate primarily to its loyalty program, a gaming entity may provide disclosures similar to those in the table in example 6-7-2 (inclusive of footnotes) to satisfy the disclosure requirements specified in FASB ASC 606-10-50-13.

6.7.123 Because gaming entities may not have performance obligations satisfied over time, a gaming entity should assess whether the disclosures in FASB ASC 606-10-50-18 are necessary to provide. In addition, because transaction prices are generally easily determinable and it may not be necessary for a gaming entity to apply significant judgment to determine the amount and timing of revenue from contracts with customers, a gaming entity should assess whether the disclosures in paragraphs 17 and 19 of FASB ASC 606-10-50 are necessary to provide. To the extent that the liabilities arising from contracts with customers noted in paragraph 6.7.116 are significant, some additional disclosure considerations may apply; however, the nature of such items would likely be described previously in the disclosure around disaggregated revenue types or in the description of the entity's performance obligations, as noted in paragraph 6.7.112.

6.7.124 FASB ASC 606-10-50-22 requires that an entity disclose whether it elects to use the practical expedients in either FASB ASC 606-10-32-18 (the "one year or less" expedient related to significant financing components) or FASB ASC 340-40-25-4 (the practical expedient that allows an entity to expense the incremental costs of obtaining a contract that is one year or less). A gaming entity will need to assess whether it has significant financing components related to the issuance and collection of markers (accounts receivable from credit granted to gaming customers) to determine if such practical expedient applies. In addition, a gaming entity should assess all fees paid to websites, online travel agents, brick-and-mortar travel agents, junket operators, and in other similar situations where such fees are paid in advance of the actual revenue being recognized, in which case the FASB ASC 340-40-25-4 practical expedient may apply.

6.7.125 The descriptive disclosures of an entity's performance obligations as outlined under FASB ASC 606-10-50-12 are required for all entities, but FASB ASC 606-10-50-16 indicates that the disclosure requirements of paragraphs 13–15 of FASB ASC 606-10-50 related to remaining performance obligations are not required for entities that are neither a public business entity

nor 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.

Promotional Allowances (Complimentaries)—Presentation and Disclosure of the Reclassification of Costs of Providing Complimentary Items to Gaming Customers

6.7.126 Prior to the adoption of FASB ASC 606, gaming entities generally reclassified the total cost incurred associated with complimentaries (such as hotel rooms and food and beverages) provided free of charge to a customer from the expense line of the department fulfilling the complimentary to the expense line of the department that granted the complimentary to the customer (typically the casino department).

6.7.127 As discussed in paragraph 6.7.25 of the section "Promotional Allowances," FinREC believes historical financial statement presentations that present revenues (1) gross for goods and services that a gaming entity gives to customers as an inducement to gamble and (2) with an offsetting reduction to gross revenues for promotional allowances or complimentaries to yield net revenues are not in accordance with FASB ASC 606. Further, as illustrated in paragraphs 6.6.18–6.6.19 of the section "Loyalty Credits and Other Discretionary Incentives (Excluding Status Benefits)" and in examples in that section, the transaction price received in a gaming transaction with a customer will be allocated to the performance obligations associated with the contract arrangements with the customer and generally will result in a reduction to reported gaming revenues and an increase to other departmental revenues for the value of goods and services "comped" to the customer or as an increase to the loyalty program liability on the balance sheet.

6.7.128 FinREC believes that the industry's historical practice of reclassifying the total cost incurred associated with complimentaries from the expense line of the department fulfilling the complimentary to the expense line of the department that granted the complimentary to the customer is not consistent with the treatment for the related revenue that will be reported under FASB ASC 606, whereby the allocation of revenue associated with the performance obligation related to the comp will be reflected in the department fulfilling the complimentary and not in the department that granted the complimentary to the customer. Gaming companies should ensure that costs and expenses are classified in the correct departmental line items to properly reflect the cost associated with the department consistent with the classification of revenue for which the cost was incurred.

6.7.129 A gaming entity should carefully consider its disclosures around complimentaries (which are treated as separate performance obligations for purposes of the allocation of the transaction price in a gaming revenue contract). Disclosures for complimentaries likely will include the following:

- a. A description of such complimentaries
- b. How the stand-alone selling price of complimentaries was determined
- c. Financial statement presentation
- d. Timing and method for measuring progress for recognizing revenue as the performance obligation is satisfied

- e. The method for determining how the transaction price is allocated and amounts allocated to complementaries
- f. Quantitative disclosures by department regarding the cost of complementaries provided, consistent with the principles underlying footnote disclosures on the cost of complementaries provided historically by gaming companies

For gaming regulatory reporting, an entity may be required to reconcile the amount reported for gaming revenue in the financial statements to the amount reported to the regulator in its gaming tax filings.

6.7.130 The following examples are meant to be illustrative, and the determination of the most appropriate disclosures in accordance with FASB ASC 606-10-50 should be based on the facts and circumstances specific to an entity.

Example 6-7-1—Disaggregation of Revenue

Background regarding the gaming entity:

- a. The entity owns and operates casinos domestically in both Las Vegas and regional markets.
- b. The entity owns and operates casinos in a number of international jurisdictions (Macau, United Kingdom).
- c. The entity manages casinos for other entities under long-term arrangements in the United States, which generally include a license to the gaming entity's brand.
- d. The economic environment of Las Vegas as a destination market is very different than either regional markets or the entity's international business.
- e. The gaming entity generates revenues at each property it operates for itself (this excludes managed properties) by providing the following types of goods and services: gaming, food and beverage, rooms, entertainment, and other.
- f. The gaming entity operates within one segment.

The following illustrates a disclosure by geographic location and type of good or service:

Revenue Disaggregation

We are a global casino operator, manager, and franchisor operating casinos domestically in both the Las Vegas and regional markets and internationally in Macau and the United Kingdom. In addition, we manage casinos for other entities in the United States under long-term agreements. We generate revenues at our owned and operated properties by providing the following types of goods and services: Gaming, Food and Beverage, Rooms, Entertainment, and Other. Our revenue disaggregated by type of revenue and geographic location is as follows:

For the period Ended [Month xx, 2017]

	Las Vegas	Regional	Managed	International	Total
Gaming	\$ 1,000.0	\$ 900.0	\$ 2,000.0	\$ 800.0	\$ 4,700.0
Rooms	500.0	300.0	100.0	350.0	1,250.0
Food and Beverage	600.0	350.0	100.0	500.0	1,550.0
Entertainment	550.0	50.0	50.0	250.0	900.0
Other	10.0	5.0	350.0	5.0	370.0
	\$ 2,660.0	\$ 1,605.0	\$ 2,600.0	\$ 1,905.0	\$ 8,770.0

Example 6-7-2—Revenue Recognized Included in the Contract Liability Balance at the Beginning of the Period

A gaming entity provides numerous goods and services to its customers. There is often a difference between the timing of a customer paying cash to the gaming entity and the satisfaction (and subsequent recognition of revenue) of the associated performance obligations. Associated with these various goods and services, a gaming entity has concluded that its customer-related liabilities generally have two relatively homogenous categories: contract liabilities associated with its loyalty program and all other customer-related liabilities. For example, in some cases, customers will make deposits in advance of property visitation, and in other cases a customer will have items that may be converted readily into cash such as chips, tokens, or a winning betting slip from a slot machine or a race and sports book. The gaming entity may choose to provide disclosure of such obligations as exhibited in the following:

Customer-Related Liabilities, Contract Assets, and Capitalized Costs

We have two general types of liabilities related to contracts with customers: (1) our Loyalty Credit Obligation and (2) advanced payments on goods and services yet to be provided or for unpaid wagers including:

- deposits on rooms and convention space
- customer safekeeping
- money deposited on behalf of a customer in advance of their property visitation (often called "front money")
- outstanding tickets generated by slot machine play
- outstanding chip liabilities
- race and sports futures and unpaid winning wagers related to past race and sports wagers

Our capitalized costs generally consist of sales commissions paid to third-party travel agencies in advance of the service being provided to our customer.

The following table summarizes the liability activity related to contracts with customers for the reporting period:

	Loyalty Credit Obligation ³		Customer Advances and Other		Customer-Related Liabilities	
	2017	2016	2017	2016	2017	2016
Balance, beginning of period	\$475.0	\$550.0	\$200.0	\$175.0	\$675.0	\$725.0
Additional amounts allocated to obligation	575.0	475.0	125.0	75.0	700.0	550.0
Reductions not from beginning balance ¹	(300.0)	(300.0)	—	—	(300.0)	(300.0)
Reductions from beginning balance ²	(325.0)	(250.0)	(75.0)	(50.0)	(400.0)	(300.0)
Balance, end of period	\$425.0	\$475.0	\$250.0	\$200.0	\$675.0	\$675.0

¹ Includes amounts both awarded and redeemed within the same fiscal period.

² Loyalty Credit Obligation reductions represent amounts recognized in revenue from the balance presented at the beginning of the period. Customer Advances and Other reductions generally represent amounts returned or paid to or otherwise used by customers.

³ Loyalty credit obligations are generally satisfied as follows: 75 percent within one year of issuance, 15 percent within two years of issuance, and the remainder within three years of issuance.

Example 6-7-3—Accounting Policy Disclosures for a Gaming Entity

Assumptions for this example:

The entity is a single casino with hotel and food and beverage operations. Further, the gaming entity does not grant credit (issue markers) to gaming customers, and wagers are not accepted on events or transactions that occur beyond the current day. The gaming entity has a simple loyalty program in which a customer earns points based only on the volume of gaming play; the points can be redeemed for hotel or food and beverage offerings. Customers can purchase rooms and food and beverages at the casino property for cash or through the redemption of loyalty points. For purposes of this example, the gaming entity does not provide any other incentives (discretionary or nondiscretionary) to customers other than the points earned in the loyalty program.

The following is an example of the accounting policy disclosure this entity might make regarding its revenue recognition accounting policies. Other disclosures such as those in example 6-7-2 would also need to be provided.

Note 2—Summary of Significant Accounting Policies

Revenue Recognition—the Company's revenue contracts with customers consist of gaming wager, hotel room sales, and food and beverage transactions. The transaction price for a gaming wager contract is the difference between gaming wins and losses, not the total amount wagered. The transaction price for hotel and food and beverage contracts is the net amount collected from the customer for such goods and services. Hotel and food and beverage services have been determined to be separate, stand-alone performance obligations and the transaction price for such contracts is recorded as revenue as the good or service is transferred to the customer over their stay at the hotel or when the delivery is made for the food and beverage. In the case of a hotel contract involving multiple days, the total transaction price of the stay

is recognized on a straight-line basis because the contract for the total days of stay is non-cancellable by the customer. The Company collects advanced deposits from hotel customers for future reservations representing obligations of the Company until the room stay is provided to the customer.

Gaming wager contracts involve two performance obligations for those customers earning points under the Company's loyalty program and a single performance obligation for customers who don't participate in the program. The Company applies a practical expedient by accounting for its gaming contracts on a portfolio basis because such wagers have similar characteristics and the Company reasonably expects the effects on the financial statements of applying the revenue recognition guidance to the portfolio to not differ materially from that which would result if applying the guidance to an individual wagering contract. For purposes of allocating the transaction price in a wagering contract between the wagering performance obligation and the obligation associated with the loyalty points earned, the Company allocates an amount to the loyalty point contract liability based on the stand-alone selling price of the points earned, which is determined by the value of a point that can be redeemed for a hotel room or food and beverage. An amount is allocated to the gaming wager performance obligation using the residual approach because the stand-alone price for wagers is highly variable and no set established price exists for such wagers. The allocated revenue for gaming wagers is recognized when the wagers occur because all such wagers settle immediately. The loyalty point contract liability amount is deferred and recognized as revenue when the customer redeems the points for a hotel room stay or for food and beverage and such goods or services are delivered to the customer. See Note X for additional disclosures regarding our liabilities related to advance hotel room deposits and loyalty points outstanding.

Gaming Entity's Costs to Obtain a Management Contract

This Accounting Implementation Issue Is Relevant to Accounting for Gaming Entity's Costs to Obtain a Management Contract.

Background

6.7.131 A gaming entity may incur, 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 contract. Frequently, the managed property is owned by a state, local, or tribal government.

6.7.132 The gaming entity, in some circumstances, pays or commits to pay amounts to organizations (designees) designated by the owner of the managed property. Often, 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.

6.7.133 The gaming entity may also enter into arrangements that promise distinct goods or services to the managed property and its designees in its efforts to obtain the right to manage the property.

6.7.134 The primary accounting literature applicable to amounts incurred to obtain management contracts is FASB ASC 606; FASB ASC 340-40, *Other Assets and Deferred Costs—Contracts with Customers*; and FASB ASC 470-10-25 as it relates to amounts contingent on future earnings.

6.7.135 FinREC believes that all arrangements that the gaming entity enters into with the managed property or designees in connection with its efforts to obtain the rights to manage the property should initially be evaluated to determine if such arrangements are within the scope of FASB ASC 606. Particular attention should be given to identifying whether the commitment to the managed property or entity under common control includes a performance obligation.

Consideration Paid or Payable to Managed Property

6.7.136 With respect to consideration paid or payable to a customer (the managed property), unless the payment to the managed property is in exchange for a distinct good or service that the managed property transfers to the gaming entity, the gaming entity should apply the guidance in paragraphs 25–27 of FASB ASC 606-10-32 to consideration paid or payable to the managed property or designees of the managed property. In accordance with FASB ASC 606-10-32-25, such consideration payable is accounted for as a reduction of the transaction price and, therefore, reduces the amounts recognized by the gaming entity as revenue for managing the property because the payment made by the gaming entity is not in exchange for a distinct good or service that the managed property transfers to the gaming entity. In accordance with FASB ASC 606-10-32-27, the gaming entity should recognize the reduction of revenue when (or as) the later of either of the following events occurs:

- a. The gaming entity recognizes revenue for the transfer of the related goods or services to the customer.
- b. The gaming entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by customary business practices.

6.7.137 The following examples are meant to be illustrative, and the actual determination of the appropriate accounting under FASB ASC 606 should be based on the facts and circumstances of an entity's specific situation.

Example 6-7-4

Assume that in its efforts to obtain the rights to manage a gaming property, the gaming entity simultaneously enters into a separate arrangement to raze and reconstruct an aged infrastructure facility on land owned by a governmental organization under common control with the managed property. The contract requires no additional consideration to be paid to the gaming entity for the related goods and services. The gaming entity concluded that the contract is within the scope of FASB ASC 606. In accordance with FASB ASC 606-10-25-9, it was determined that this contract should be combined with the management contract and accounted for as a single arrangement because the two contracts were entered into at or near the same time with related parties and were negotiated as a package with a single commercial objective. The entity would assess the specific facts to determine if a single performance obligation or multiple performance obligations exist. Separate performance obligations might exist for an obligation to manage the property and an obligation to raze and reconstruct the facility. The transaction price would be allocated to each separate performance obligation determined to exist in the arrangement.

Example 6-7-5

Assume the same facts as in example 6-7-4 except that the gaming entity agrees to provide funding to the governmental organization for the reconstruction and is not required to provide any goods or services and thus has no performance obligation to raze and reconstruct the facility. It is determined that the consideration payable is to an entity under common control with the managed property, and therefore the guidance in paragraphs 25–27 of FASB ASC 606-10-32 should be applied. In accordance with FASB ASC 606-10-32-25, the consideration payable is accounted for as a reduction of the transaction price paid to the gaming entity to manage the property. The gaming entity recognizes the amounts it pays to the entity under common control with the managed property as a reduction of revenue recognized over the term of the management contract.

Contract Costs Incurred by a Gaming Entity Other Than Prepaid Costs

6.7.138 FASB ASC 340-40 provides guidance on contract costs that are not within the scope of other authoritative literature. If another FASB ASC topic addresses a particular cost, then that cost is outside of the scope of FASB ASC 340-40, and such guidance cannot be used to capitalize costs that are precluded from capitalization under other topics.

6.7.139 As discussed in FASB ASC 340-40-25-5, only costs incurred that directly relate to a management contract (or anticipated contract) that will be used to satisfy future performance obligations and are expected to be recovered are eligible for capitalization.

6.7.140 In accordance with FASB ASC 340-40-25-1, incremental costs incurred by the gaming entity to obtain a management contract (excluding any consideration payable to the managed property or entities under common control) should be recognized as an asset if the entity expects to recover those costs. These capitalized costs are considered management contract acquisition costs. In accordance with FASB ASC 340-40-25-3, costs to obtain a management contract that would have been incurred regardless of whether the management contract was obtained should be recognized as an expense when incurred, similar to the accounting treatment for the costs incurred in efforts to obtain gaming licenses.

6.7.141 Assets recognized (including any commission fees paid to sales people in conjunction with obtaining the contract recognized as an asset) typically have a finite life and should be amortized over a life equal to the term of the management contract (including any renewal periods expected to be exercised) on a systematic basis that is consistent with the transfer to the customer of the management services to which the asset relates as required in FASB ASC 340-40-35-1. If an entity determines that commissions paid on contract renewals are commensurate with the commission paid on the initial contract, then any commission fee paid to sales people in conjunction with obtaining the initial contract recognized as an asset should only be amortized over the initial term of the management contract consistent with the discussion in BC309 of FASB ASU No. 2014-09 and as discussed in TRG Agenda Ref 57, *Capitalization and Amortization of Incremental Costs of Obtaining a Contract*. In the case of managing a casino, FinREC believes that the method most consistent with the transfer to the customer will often be the straight-line method over the term of the management contract. In accordance with FASB ASC 340-40-35-3, a gaming entity should recognize an impairment loss to the extent the carrying amount of the recorded asset exceeds the sum of the remaining amounts

expected to be collected under the management contract and that the entity has received but not yet recognized as revenue less the costs to provide the goods or services under the contract that have not been recognized as expenses. In accordance with FASB ASC 340-40-35-6, a gaming entity should not reverse an impairment loss previously recognized.

Gaming Entity's Costs Related to an Existing Management Contract

6.7.142 The gaming entity may incur costs (excluding any consideration payable to the managed property or its designee that is not in exchange for a distinct good or service that the managed property transfers to the gaming entity) during the term of the management contract that are similar in character to the costs incurred in efforts to obtain the contract and which are determined not to be costs incurred to fulfill the management contract as defined in FASB ASC 340-40-25-5. If these costs meet the provisions of FASB ASC 340-40-25-1, they should be capitalized, amortized, and evaluated for impairment as described in paragraphs 6.7.139–6.7.141. The entity would determine whether costs incurred to comply with such requirements meet the provisions of FASB ASC 340-40-25-1. Costs incurred during the term of the management contract that would have been incurred regardless of whether the management contract was renewed should be recognized as an expense when incurred in accordance with FASB ASC 340-40-25-3.

Appendix K

Schedule of Changes Made to the Text From the Previous Edition

As of September 1, 2018

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>
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.
Preface	Updated.
Paragraph 1.16	Revised, not related to an issuance of new authoritative guidance.
Paragraph 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 1.37	Revised for changes in the gaming industry, not related to an issuance of new authoritative guidance.
Paragraph 1.39	Revised due to the passage of time.
Footnote 1 to the heading before paragraph 7.01	Added to refer readers to appendix J, "Revenue Recognition Implementation Issues."
Footnote 1 in chapter 13	Revised due to the passage of time.
Footnote 10 in paragraph 13.98	Revised to refer readers to appendix J.

(continued)

<i>Reference</i>	<i>Change</i>
Paragraphs 13.167–.174	Revised to reflect the issuance of Statement on Auditing Standards (SAS) No. 132, <i>The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i> (AU-C sec. 570); former footnote 18 deleted.
Paragraphs 13.175–.181	Added to reflect the issuance of SAS No. 132.
Paragraph 13.182	Revised to reflect the issuance of SAS No. 132.
Footnote 1 to the heading before paragraph 16.01	Added to refer readers to appendix J.
Appendix B	Revised for passage of time.
Appendix C	Revised to reflect the issuance of FASB Accounting Standards Update (ASU) No. 2015-17, <i>Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes</i> . Footnote 1 added to refer reader to appendix J.
Footnote 1 in appendix D	Added to clarify the status of revisions related to revenue recognition standards and to refer readers to appendix J.
Footnote 2 in appendix E	Added to reflect issuance of FASB ASU No. 2016-01, <i>Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities</i> .
Footnote 1 in appendix G	Added to clarify the status of revisions related to revenue recognition standards and to refer readers to appendix J.
Appendix I	Revised to reflect GASB Statement No. 87, <i>Leases</i> .
Appendix J	Added to reflect the finalized revenue recognition implementation issues found in chapter 6, "Gaming Entities," of the AICPA Audit and Accounting Guide <i>Revenue Recognition</i> .
Footnote 1 in the glossary	Added to clarify the status of revisions related to revenue recognition standards and to refer readers to appendix J.

Glossary¹

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**.

¹ See appendix J, "Revenue Recognition Implementation Issues," of this guide for terminology and other revisions applicable to nongovernmental entities resulting from the implementation of FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers (Topic 606)*. Guide content will be updated in a future edition.

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 by the gaming entity 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 interconnected with a lottery's central computers.
- 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 within a jurisdiction 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.

Index of Pronouncements and Other Technical Guidance

A

<i>Title</i>	<i>Paragraphs</i>
AU-C Section	
200, <i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards</i>	13.03–.04, 13.12–.14, 13.17–.18
210, <i>Terms of Engagement</i>	13.05–.10
220, <i>Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards</i>	13.05, 13.147
230, <i>Audit Documentation</i>	13.136–.143
240, <i>Consideration of Fraud in a Financial Statement Audit</i>	13.33, 13.39, 13.44, 13.73–.81, 13.92–.103, 13.105–.111
250, <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i>	13.112–.114, 13.117, Appendix F
260, <i>The Auditor's Communication With Those Charged With Governance</i>	13.161
265, <i>Communicating Internal Control Related Matters Identified in an Audit</i>	13.162–.165
300, <i>Planning an Audit</i>	13.14–.15, 13.147
315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	13.15, 13.20, 13.23–.24, 13.32, 13.35–.36, 13.39, 13.45–.47, 13.49, 13.51–.53, 13.56–.62, 13.66–.67, 13.73, 13.78, 13.92, 13.171, 14.36
320, <i>Materiality in Planning and Performance of an Audit</i>	13.26–.31
330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluation of the Audit Evidence Obtained</i>	13.15, 13.19, 13.21, 13.51, 13.73, 13.104, 13.118–.126, 13.129, 14.32

<i>Title</i>	<i>Paragraphs</i>
<i>402, Audit Considerations Relating to an Entity Using a Service Organization</i>	13.69
<i>450, Evaluation of Misstatements Identified During the Audit</i>	13.26, 13.107, 13.150–.151
<i>500, Audit Evidence</i>	13.103, 13.147, 14.32
<i>505, External Confirmations</i>	14.32–.36, 14.43
<i>510, Opening Balances—Initial Audit Engagements, Including Reaudit Engagements</i>	13.11
<i>520, Analytical Procedures</i>	13.131–.134
<i>550, Related Parties</i>	13.41–.43
<i>570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i>	13.167–.174, 13.177–.179, 13.181–.182
<i>580, Written Representations</i>	13.152–.160
<i>600, Special Considerations—Audits of Group Financial Statements</i>	13.14, 13.183–.185
<i>610, Using the Work of Internal Auditors</i>	13.144
<i>620, Using the Work of an Auditor's Specialist</i>	13.145–.149
<i>700, Forming an Opinion and Reporting on Financial Statements</i>	13.107, 13.151
<i>705, Modifications to the Opinion in the Independent Auditor's Report</i>	13.160, 13.180
<i>720, Other Information in Documents Containing Audited Financial Statements</i>	13.189
<i>725, Supplementary Information in Relation to the Financial Statements as a Whole</i>	13.190
<i>730, Required Supplementary Information</i>	13.191
<i>940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	13.166
Audit and Accounting Guides (AAG)	
<i>Revenue Recognition</i>	3.01
<i>State and Local Governments</i>	2.03, 12.01, 12.11, 13.192

F

<i>Title</i>	<i>Paragraphs</i>
FASB ASC	
105, <i>Generally Accepted Accounting Principles</i>	2.02
205, <i>Presentation of Financial Statements</i>	
205-40	13.170
235, <i>Notes to Financial Statements</i>	11.27
235-10	6.29
250, <i>Accounting Changes and Error Corrections</i>	10.11–12
280, <i>Segment Reporting</i>	11.24
280-10	13.37
350, <i>Intangibles—Goodwill and Other</i>	7.03, 8.05, 8.10, 9.03, 11.01
350-30	7.08–10, 9.15, 9.24–27
360, <i>Property, Plant, and Equipment</i>	7.11, 8.05, 8.09–10, 9.03, 10.02–10, 10.13–18
360-10	9.27, 10.04, 10.07, 10.10, 10.13–18
410, <i>Asset Retirement and Environmental Obligations</i>	10.02
410-20	10.21
450, <i>Contingencies</i>	6.01, 7.03, 8.05, 9.03, 9.17
450-20	6.01, 9.04, 9.22
460, <i>Guarantees</i>	9.02–.03, 9.09, 9.17, 9.22, Appendix D
460-10	9.03, 9.04–.05, 9.09, 9.16, 9.28
470, <i>Debt</i>	
470-10	8.05, 8.19
605, <i>Revenue Recognition</i>	6.01, 8.05, 9.03
605-20	9.03, 9.16
605-25	6.22, 9.03, 9.23

<i>Title</i>	<i>Paragraphs</i>
605-45	4.10, 5.04, 5.08, 8.13
605-50	6.01, 6.06, 6.12–.14, 6.17, 6.20, 6.23, 9.03, 9.23, 11.22
606, <i>Revenue from Contracts with Customers</i>	3.01, Appendix B, Appendix J
340-40	Appendix B
606-10	3.01
720, <i>Other Expenses</i>	
720-15	7.03, 7.14–.15
810, <i>Consolidations</i>	9.29
810-10	9.29
815, <i>Derivatives and Hedging</i>	9.16
820, <i>Fair Value Measurements and Disclosures</i>	9.03, 9.06
820-10	9.03
825, <i>Financial Instruments</i>	9.03, 9.16
840, <i>Leases</i>	5.04, 9.09
840-10	5.04, 5.05–.06
840-20	9.09
850, <i>Related Party Disclosures</i>	8.20
924, <i>Entertainment—Casinos</i>	3.01, 4.02
924-280	11.26
924-405	11.15
924-605	3.05, 3.41–.42, 4.08, 5.07
924-720	3.41
924-740	11.28
970, <i>Real Estate—General</i>	7.03, 7.12
970-360	7.12
985, <i>Software</i>	5.04
FASB ASU No. 2016-02, <i>Leases (Topic 842)</i>	Appendix I
FASB Concepts Statement No. 6, <i>Elements of Financial Statements</i>	6.01, 9.12

G

<i>Title</i>	<i>Paragraphs</i>
GASB Statement	
No. 14, <i>The Financial Reporting Entity</i>	12.11–.12
No. 34, <i>Basic Financial Statements for State and Local Governments</i>	12.22
No. 42, <i>Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries</i>	12.17–.18
No. 56, <i>Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards</i>	13.170
No. 62, <i>Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements</i>	Appendix I
No. 63, <i>Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position</i>	12.08–.09
No. 72, <i>Fair Value Measurement and Applications</i>	12.12
No. 76, <i>The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments</i>	2.02, 12.02–.03, Appendix A

Q

<i>Title</i>	<i>Paragraphs</i>
Q&A section 8800, <i>Audits of Group Financial Statements and Work of Others</i>	13.188

S

<i>Title</i>	<i>Paragraphs</i>
SEC SAB Topic 13, <i>Revenue Recognition</i>	5.04, 6.01

Subject Index

A

- AGENTS, LOTTERY** 1.13–14
- ALLOWANCE FOR DOUBTFUL ACCOUNTS** 14.47–52
- AMORTIZATION, DEBT GUARANTEES** 9.23–27
- ANALYTICAL PROCEDURES** 16.01–12
 - General auditing considerations 13.131–135
 - Generally 16.01
 - Performance and execution of audit 13.131–135
 - Risk assessment 13.53–54, 13.93
 - Timing of audit procedures 13.129
 - Types of 16.05–12
- ANNUNZIO-WILEY ANTI-MONEY LAUNDERING ACT OF 1992** 13.115
- ASSERTIONS IN OBTAINING AUDIT EVIDENCE** 13.18–21, 13.23–24, Table at 13.23
- ASSETS**
 - Capitalization of 8.09–12
 - Cash flow estimates for recoverability testing 10.13–20
 - Fraud risk and fixed assets 13.97
 - Governmental gaming entity 12.08–10, 12.12, 12.15–21
 - Guarantees 9.12, 9.23–27
 - Impairment of capital assets 7.10–11, 12.17–21
 - Intangible. See intangible assets
 - Licensing 7.08–11
 - Long-lived. See long-lived assets
 - Misappropriation of 13.88–91
 - Start-up cost analysis 7.12–13
 - Third party property management 8.05, 8.09–12
- AUDIT DOCUMENTATION. See documentation**
- AUDIT EVIDENCE**
 - Assertions in obtaining 13.18–21, 13.23–24, Table at 13.23
 - Evaluation of 13.103–107
 - External confirmations to obtain 14.32–36, 14.43–44
 - Further audit procedures 13.19, 13.21, 13.118–126
 - Internal control 13.63–64, 13.68
 - Written representations as 13.153
- AUDIT PLANNING** 13.14–16, 13.25–28, 13.101, 14.37
- AUDIT RISK** 13.12–13, 13.17–22

AUDITING CONSIDERATIONS. See general auditing considerations; special auditing considerations

AUDITORS

- Audit objectives of 13.03–04
- Communication to management and with those charged with governance. See communication
- From component units 13.186–187
- Discussion among audit team 13.39, 13.78–81
- Generally 13.12–13
- Inability to continue the engagement ... 13.108
- Internal auditors, using work of 13.34, 13.144
- Legal compliance 13.112, 13.114–117
- Opinion of. See opinion
- Predecessor auditor 13.10
- Professional judgment 13.35
- Professional skepticism 13.51, 13.76–77
- Related parties 13.43–44
- Role in planning an audit 13.14–16

AUDITOR'S REPORT, GOING CONCERN CONSIDERATION 13.179–180

B

- BAD DEBT RESERVES, FRAUD RISK IN** 13.97
- BALL-DRAWING PROCEDURES FOR LOTTERIES** 15.35
- BANK SECRECY ACT OF 1970 (BSA)** ... 1.37, 13.115
- BANKED GAMES, DEFINED** 3.01
- BANKROLL, DEFINED** 1.39
- BASE JACKPOTS, DEFINED** 4.03
- BASE PROGRESSIVE JACKPOT** 4.03, 4.07–08
- BINGO**
 - Analytical procedures 16.07
 - Card sale controls 15.16
 - Cash count 15.19
 - Cutoff procedures 14.20
 - Generally 1.44
 - Hold percentage factors 16.09
 - Internal control 15.16–19
 - Number selection controls 15.17
 - Payout controls 15.18
 - U.S. distribution of Table 1-1 at 1.19
- BLENDING OF FINANCIAL STATEMENTS, GOVERNMENTAL GAMING ENTITIES** 12.11–12
- BOOTH CASHIER, DEFINED** 3.23

BOXPERSONS, DEFINED	1.39
BRANCH OFFICES	14.46
BREAKAGE	11.17
BUSINESS COMBINATION, INTANGIBLE ASSETS ACQUIRED IN	11.01–04
BUSINESS RISK AND GAMING RISK, DISTINGUISHING BETWEEN	3.03, 3.12
BUSINESS-TYPE ACTIVITIES OF GOVERNMENTAL ENTITIES	12.06, 12.11

C

CAGE ACCOUNTABILITY

· Cage and general ledger control	3.30–32
· Casino transactions	3.14–32
· Components	14.03–05
· Customer deposits	14.12, 15.20
· Defined	3.15, 3.21
· Generally	3.30–32
· Internal control	14.10–11, 15.20–22
· Procedures	14.05–06
· Reconciliation	3.30
· Slot machine cycle	3.21–29
· Table games	3.14–20
· Testing	14.07–13

CAPITAL ASSET IMPAIRMENT	7.10–11, 12.17–21
---------------------------------------	--------------------------

CAPITAL CONTRIBUTIONS, GOVERNMENTAL GAMING ENTITY REPORTING

CAPITALIZATION OF COSTS

· Licensing	7.06
· Property management related	8.09–12

CARD GAMES/ROOMS

· Cutoff procedures	14.22
· Generally	1.40
· Internal control procedures	15.23–25
· Poker	1.40, 16.07, 16.10–12
· Use of by state	1.21, Table 1-1 at 1.19

CASH AND CASH EQUIVALENTS

· Balances and revenue cutoff	14.02–06
· Cage accountability. <i>See</i> cage accountability	
· Counting. <i>See</i> counting	
· Coupons or incentives	3.38
· Currency transaction reporting	Appendix F
· Cutoff procedures	14.14–22
· Discretionary incentives	6.14–15
· Loyalty programs	6.20–21
· Special auditing considerations	14.02–27
· Table game transactions	3.14

CASH COUNT SHEET, DEFINED

CASH FLOW ESTIMATES FOR ASSET RECOVERABILITY TESTING	10.13–20
---	-----------------

CASHLESS WAGERING SYSTEM, DEFINED	15.44
--	--------------

CASINO CAGE, DEFINED. <i>See also</i> cage accountability	3.14
--	-------------

CASINOS

· Cage accountability	3.14–32
· Chips and tokens	11.14–18
· Deferred income taxes	11.28
· Fees charged to gaming entities	4.10
· Generally	1.01–09, Table 1-1 at 1.19
· Jackpot liabilities	4.02–07, 4.08
· New Jersey CRDA	1.37, Appendix E
· Promotional allowances	3.41–42
· Revenue recognition	3.05
· Segment reporting	11.26

CATEGORY B GUIDANCE,

GASB	Appendix A
-------------------	-------------------

CHANGE PERSON, DEFINED	3.23
-------------------------------------	-------------

CHIP FLOAT	3.31, 11.17
-------------------------	--------------------

CHIPS

· Cage accountability	3.31, 14.03–05, 14.10–11
· Defined	3.14
· Liabilities for	11.14–18
· Promotional chips	3.39
· Transactions generally	3.14–19

CLOSERS, DEFINED	3.16
-------------------------------	-------------

CLOSING PROCESS, TESTING	13.126
---------------------------------------	---------------

CLUB STATUS, DEFINED	3.34
-----------------------------------	-------------

COIN IN, DEFINED	5.01
-------------------------------	-------------

COINLESS SLOT MACHINES	1.41
-------------------------------------	-------------

COMMUNICATION. *See also* management

· Fraud consideration	13.92, 13.109–110
· Generally	13.109
· Internal control matters	13.162–166
· With those charged with governance	13.109–110, 13.161–166, 13.181

COMPACT, DEFINED	1.10
-------------------------------	-------------

COMPLIMENTARIES	3.41, 6.16, 6.22–26
-----------------------------	----------------------------

COMPONENT UNITS, AUDITORS FROM	13.186–187
---	-------------------

COMPUTERIZED GAMING

SYSTEMS	13.65–72
· Bingo	15.16
· Internal control	15.27–30
· Keno ticket controls	15.31
· Lottery controls	15.36
· Online gaming. <i>See</i> online gaming	
· Race and sports book	15.39–43

CONFIRMATION OF RECEIVABLES. <i>See</i> external confirmation of receivables	
---	--

CONSOLIDATION OF FINANCIAL STATEMENTS, GOVERNMENTAL GAMING ENTITIES	12.11–12
--	-----------------

CONTINGENCIES	6.01, 7.03, 8.05, 9.03, 9.04, 9.22
---------------------------	---

- CONTRA TO REVENUE, GUARANTEE AS**9.23
- CONTRACT CLASSIFICATION GUARANTEES** 9.15
- CONTROL RISK** 13.21, 13.63
- COST ACCRUAL MODEL** 6.10, 6.12, 6.23–24, Table at 6.26
- COSTS OF GAMING**
- Capitalization of 7.06, 8.09–12
 - Customer acquisition cost 9.15
 - Marketing/promotion 3.13, 6.05
 - Other expenses category 7.03, 7.14–15
 - Start-up costs 7.01–15
 - Subsequent measurement of guarantee asset 9.23
 - Subsequent measurement of guarantee liability 9.23
 - Taxes and fees 1.33–34
 - Third party-owned property accounting 8.07–15
- COUNTER CHECKS, DEFINED. See also markers** 14.30
- COUNTING**
- Bingo 15.19
 - Cage 14.10–11, 15.22
 - Card room 15.23
 - Drop box procedures 14.24–27, 15.24
 - General audit considerations 13.129
 - Keno 15.34
 - Lotteries 15.37
 - Race and sports betting 15.42
 - Slot machines 15.45–46
 - Special auditing considerations 14.06–13
 - Table games 15.52
- CRDA. See New Jersey Casino Reinvestment Development Authority**
- CREDIT, GRANTING AND CONTROL OF** 15.10–15
- Approval of credit lines 15.10
 - Custody of markers 14.17, 15.12, 15.14–15
 - Incentive programs 3.35, 3.40
 - Issuance of credit 15.11–12
 - Maintenance of credit files 15.10
 - Recording transactions 3.15, 15.13
 - Table games 15.50
 - Understanding policies for 14.30
- CREDIT LIMITS, DEFINED** 14.28
- CREDIT SLIP, DEFINED** 3.15
- CRUISE SHIP GAMING** 1.17
- CURRENCY ACCEPTOR DROP BOXES, DEFINED** 14.18
- CURRENCY ACCEPTORS, DEFINED** 3.25
- CURRENCY TRANSACTION REPORTING. See also cash and cash equivalents** Appendix F
- CUSTOMER DEPOSITS** 14.03, 14.12, 15.20
- CUSTOMERS**
- Acquisition cost guarantees 9.15
 - Credit for. See credit
 - External confirmation of receivables 14.38–45, 14.47–48
 - Incentives. See loyalty and incentive programs
 - Privacy of financial information 1.37
 - Relationship as intangible asset 11.03–04
 - Voucher-operated gaming devices 14.19
 - Wagering accounts for 3.26, 15.21
- CUTOFF PROCEDURES** 14.14–22
- Bingo 14.20
 - Card games 14.22
 - Cash balances and revenue cutoff 14.02–06
 - Generally 14.14–15
 - Keno 14.20
 - Racing and sports books 14.21
 - Slot machines 14.18–19
 - Table games 14.16–17
- D**
- DATA PROCESSING CONTROLS** 15.08
- DATE OF AND PERIOD(S) COVERED BY WRITTEN REPRESENTATIONS** 13.158
- DEALERS, DEFINED** 1.39
- DEBT GUARANTEES. See guarantees**
- DEFERRED INCOME TAXES FOR CASINOS** 11.28
- DEFERRED INFLOWS AND OUTFLOWS OF RESOURCES** 12.08–10
- DEFERRED REVENUE MODEL** 6.10–11, 6.19, 6.25–26, Table at 6.26
- DETECTION RISK** 13.17
- DISCLOSURES**
- Going concern consideration 13.177–178
 - Guarantees 9.28–29
 - Loyalty and incentive programs 6.29
 - Third party property management situations 8.15, 8.20–21
- DISCRETIONARY INCENTIVE PROGRAMS** 6.13–16
- Cash or cash equivalents 6.14–15
 - Complimentaries 6.16
 - Defined 3.33, 6.02
 - Free play 6.13
 - Generally 6.03–08
- DOCUMENTATION** 13.136–143
- Analytical procedures 13.133
 - Assembly and retention of final audit file 13.143
 - Defined 13.138
 - Fraud consideration 13.111
 - Generally 13.136–138

DOCUMENTATION — *continued*

- Going concern evaluation 13.182
- Other information 13.189
- From other specialists 13.145–149
- Timely preparation of 13.139–142

DRAW TICKET, KENO 15.32**DROP**

- Defined 16.07
- Slot drop, defined 3.24
- Win-to-drop percentage analysis 16.10–12
- DROP BOXES
- Count procedures 14.24–27, 15.24
- Currency acceptor 14.18
- Defined 3.14, 3.15
- Slot machine controls 15.46
- Table game controls 15.52

DROP BUCKETS 3.22, 3.24**E****ELECTRONIC MONEY TRANSFERS 3.26****ENGAGEMENT**

- Auditor's withdrawal from 13.108
- Group audit engagement 13.183–188
- Terms of 13.05–10

EQUITY INTERESTS IN LEGALLY SEPARATE ORGANIZATIONS, GOVERNMENTAL GAMING ENTITIES 12.12**ESTIMATES OF FUTURE CASH FLOWS FROM LONG-LIVED ASSETS 10.18****EXPENSES. *See* costs of gaming****EXTERNAL CONFIRMATION OF****RECEIVABLES 14.32–45**

- Alternative procedures when no reply is received 14.45
- Generally 14.32–41
- Mail circularization 14.42
- Oral responses 14.43–44

EYE IN THE SKY, DEFINED 15.06**F****FAIR VALUE MEASURES FOR GUARANTEES 9.04–10****FEDERAL GOVERNMENT, TAXES AND FEES LEVIED 1.34****FEES AND TAXES LEVIED ON GAMING ENTITIES 1.33–35****FILL CABINET, DEFINED 3.21****FILL SLIP, DEFINED 3.14****FILLS 3.21, 15.44, 15.50****FINANCIAL REPORTING, OVERVIEW OF REQUIREMENTS. *See also* financial statements 1.32****FINANCIAL REPORTING EXECUTIVE COMMITTEE (FINREC)**

- On complementaries with cost accrual model 6.23
- On free play cost 6.17
- On guarantees 9.10–11, 9.13–14, 9.23, 9.25, 9.29
- On jackpot accounting 4.09–10
- Loyalty and incentive programs 6.01, 6.10
- On managed property/gaming entity relationships as exchange transactions 8.06

FINANCIAL STATEMENTS. *See also* general auditing considerations; special auditing considerations

- Generally 2.02
- Going concern evaluation 13.179–180
- Governmental gaming entities 12.06–12, 12.22
- Group audit 13.183–188
- Guarantees 9.28–29
- Illustrative Appendix C
- Loyalty and incentive programs 6.29
- Managed property arrangements 8.15, 8.16–21
- Notes to financial statements 6.29, 11.27
- Segment reporting 11.24–26, 12.22, 13.37
- Third party property management situations 8.15, 8.20–21

FINREC. *See* Financial Reporting Executive Committee**FIXED ASSETS AND FRAUD RISK 13.97****FOREIGN CHIPS, DEFINED 14.03****FRAUD CONSIDERATION 13.73–111**

- Analytical procedures 13.53–54, 13.93
- Attitudes and rationalizations for fraud 13.87, 13.91
- Audit evidence evaluation 13.103–107
- Auditor's withdrawal from engagement 13.108
- Communication to management and with those charged with governance 13.92, 13.109–110
- Discussion among audit team 13.78–81
- Documentation 13.111
- Generally 13.73–75
- Incentives or pressures for committing fraud 13.82–84, 13.90
- Industry risk factors 13.40
- Internal control, relationship to 13.86, 13.102
- Misappropriation of assets 13.88–91
- Opportunities for fraud 13.85–86, 13.91
- Professional skepticism from auditor 13.76–77
- Related parties 13.44
- Responses to assessed risks 13.100–102
- Risk assessment procedures 13.92–99

FRAUD RISK FACTORS, DEFINED 13.94
FREE PLAY 6.13, 6.17–19
FRONT MONEY, DEFINED 15.20
FURTHER AUDIT PROCEDURES
 · Analytical procedures 13.53–54
 · Audit evidence ... 13.19, 13.21, 13.118–126
 · Internal control, relationship to 13.61
 · Response to fraud risk 13.51, 13.101
 · Risk assessment 13.48–54

G

GAAP. See generally accepted accounting principles

GAAS. See generally accepted auditing standards

GAMING 1.01–46
 · Accounting scope 2.01–04
 · Assets. *See* assets
 · Casino gaming. *See also* casinos ... 1.01–09, Table 1-1 at 1.19
 · Descriptions of games. *See also* specific games 1.38–46, Appendix G
 · Generally 1.17–24
 · Guarantees 9.01–29, Appendix D
 · History 1.01–06
 · Jackpot liabilities 4.01–10
 · Lotteries 1.07, 1.12–16, 3.06, 15.35–37, Table 1-1 at 1.19
 · Loyalty and incentive programs 6.01–29
 · Native American gaming 1.10–11, 1.37, Table 1-1 at 1.19
 · Participation arrangements 5.01–09
 · Regulation and oversight 1.25–37
 · Revenue from. *See also* revenue ... 3.01–42
 · Rules of games Appendix G
 · Start-up costs 7.01–15
 · States in U.S. 1.21, Table 1-1 at 1.19
 · Third party property management 8.01–21, 11.19–23

GAMING ACTIVITIES, DEFINED 3.01, 3.02

GAMING ENTITY. See also understanding the entity and its environment

· Accounting policies 13.36, 13.100
 · Component definition 13.186–187
 · Fees charged to 4.10
 · Fraud evaluation and types of 13.95
 · Fraud incentives and opportunities 13.82–91
 · Going concern consideration ... 13.167–182
 · Governmental 12.01–22
 · Managed property relationship 8.01–04, 8.06
 · Objectives and internal control, relationship of 13.60–62
 · Participation arrangements 5.01–09
 · Related parties to 13.41–44

GAMING ENTITY — continued

· Third party-owned property accounting 8.07–15
 · Understanding context for audit ... 13.32–40, 16.01–12

GAMING EQUIPMENT MANUFACTURERS 1.24

GAMING FACILITIES. See also property, plant, and equipment 1.23, 7.12, 10.01–21, 12.20

GAMING RELATED ACTIVITIES 3.02–03, 3.11–13

GAMING RISK, COMPARED TO BUSINESS RISK 3.03, 3.12

GAMING TOURNAMENTS 15.26

GASB. See Government Accounting Standards Board

GENERAL AUDITING CONSIDERATIONS 13.01–193

· Analytical procedures 13.53–54, 13.131–135
 · Audit risk 13.12–13, 13.17–22
 · Audit team discussion 13.39, 13.78–81
 · Communication to management and with those charged with governance 13.109–110, 13.161–166, 13.181
 · Designing and performing further audit procedures. *See further audit procedures*
 · Documentation 13.111, 13.133, 13.136–143, 13.182
 · Evaluation of identified misstatements 13.150–151
 · Fraud consideration 13.73–111
 · Generally 13.01–04
 · Going concern consideration ... 13.167–182
 · Group audit engagements 13.183–188
 · Industry risk factors 13.40
 · Internal auditor, using work of 13.34, 13.144
 · Internal control 13.55–72
 · Laws and regulations ... 13.112–117, 13.169
 · Materiality 13.25–31
 · Opening balances 13.11
 · Performance and execution of audit 13.118–135
 · Planning the audit 13.14–16, 13.25–28, 13.101, 14.37
 · Purpose, objectives and scope of audit 13.12–13
 · Related parties 13.41–44
 · Risk assessment procedures 13.23–24, 13.45–54, 13.92–99, 13.171–172
 · Risk of material misstatement. *See material misstatement, risk of*
 · Specialists, using work of 13.70, 13.80, 13.145–149
 · Supplementary and other information 13.189–193
 · Terms of engagement 13.05–10

GENERAL AUDITING**CONSIDERATIONS — *continued***

- Timing of audit procedures 13.127–130
- Understanding the entity and its environment.
See understanding the entity and its environment
- Written representations from management and those charged with governance 13.152–160

GENERAL LEDGER CONTROL, CAGE**ACCOUNTABILITY 3.30–32****GENERALLY ACCEPTED ACCOUNTING****PRINCIPLES (GAAP) 2.02, 2.04, 12.03–04, 12.07, Appendix A****GENERALLY ACCEPTED AUDITING****STANDARDS (GAAS) 13.03, 13.12–13, 13.59, 13.74, 13.137–138****GOING CONCERN****CONSIDERATION 13.167–182**

- Additional audit procedures 13.173–174
- Auditor conclusions 13.177–180
- Communicating with those charged with governance 13.181
- Conditions and events 13.175–176
- Documentation 13.182
- Generally 13.167–170
- Risk assessment procedures and related activities 13.171–172

GOVERNMENT ACCOUNTING STANDARDS**BOARD (GASB)**

- Accounting and financial reporting requirements 12.07–12
- Summary of literature 12.05

GOVERNMENTAL GAMING ENTITIES. *See also* lotteries 12.01–22

- Accounting standards applicability 12.02–04
- Asset and liability allocation 12.08–10, 12.12, 12.16–21
- Background 12.01
- Capital asset impairment 12.17–21
- Defined 1.16
- Financial statements 12.06–12, 12.22
- GAAP accounting standard 2.02
- GAAP hierarchy 2.04, 12.03–04
- Resource flows between gaming entities and governments 12.13–15
- Segment reporting 12.22
- Summary of literature 12.05
- Supplementary information 12.07

GROSS GAMING REVENUE

- Audit testing of 16.06
- Calculating 3.19–20
- Defined 3.07–08
- Slot machines 3.28
- Table gross gaming revenue 3.16

GROUP AUDIT**ENGAGEMENTS 13.183–188****GUARANTEES 9.01–29**

- Acquisition cost for contract or customer 9.15
- Financial statement disclosures 9.28–29
- Generally 9.01
- Illustrative guidance Appendix D
- Income statement effect on initial recognition 9.14
- Initial recognition and measurement 9.04–14
- Subsequent measurement of asset 9.23–27
- Subsequent measurement of liability 9.16–22
- Summary of literature 9.02–03

H**HARD COUNT, DEFINED 3.24****HOLD CHECKS, DEFINED 14.30****HOLD PERCENTAGES 3.27, 4.01, 16.09****HOPPER, DEFINED 3.21****HOPPER LOAD, DEFINED 3.21****HOUSE, DEFINED 1.39****HUMAN CONTROLS 15.07****I****IGRA. *See* Indian Gaming Regulatory Act****IMMEDIATE REVENUE MODEL 6.10, 6.12, 6.23–24, Table at 6.26****INCENTIVE PROGRAMS. *See* loyalty and incentive programs****INCENTIVES AND OPPORTUNITIES FOR FRAUD 13.82–91****INCOME. *See* revenue****INCOME STATEMENT 5.06–09, 9.14****INCREMENTAL PROGRESSIVE AMOUNT 4.05, 4.07, 4.09****INDEFINITE-LIVED INTANGIBLE ASSET 7.10****INDIAN GAMING REGULATORY ACT OF 1988 (IGRA) 1.10–11, 1.37****INDUSTRY-SPECIFIC FACTORS FOR AUDITOR 13.07, 13.40****INFORMATION TECHNOLOGY (IT). *See also* computerized gaming systems 13.65–72, 15.27–30****INHERENT RISK 13.21–22****INITIAL AND REAUDIT ENGAGEMENT, DISTINGUISHING BETWEEN 13.11****INSTANT GAME TICKETS 1.14, 15.37**

INTANGIBLE ASSETS

- Acquired in business combination 11.01–04
- Capital impairment 7.08–11
- Exclusion of as primary long-lived assets 10.15
- Guarantees 9.03, 9.12, 9.15, 9.24–27
- Licensing 5.02, 7.03, 11.01
- Third party property management 8.05, 8.09–12
- Trademarks as 11.02

INTERNAL AUDIT FUNCTION 13.87**INTERNAL AUDITORS, USING WORK****OF 13.34, 13.144****INTERNAL CONTROL 15.01–53**

- Audit evidence 13.63–64, 13.68
- Bingo 15.16–19
- Cage accountability ... 14.10–11, 15.20–22
- Card games 15.23–25
- Communicating deficiencies in 13.162–166
- Components 13.59, 13.67
- Credit granting and control 15.10–15
- External confirmation of receivables 14.38
- Fraud consideration 13.86, 13.102
- Gaming tournaments 15.26
- General audit testing ... 13.64, 13.122–125, 13.128–129, 13.134
- Generally 13.02, 13.55–64, 15.01–09
- Incentive programs 15.38
- IT considerations 13.65–72, 15.27–30
- Keno 15.31–34
- Lotteries 15.35–37
- Material misstatement risk assessment 13.55–72, 13.92, 13.99
- Override of controls by management 13.102
- Promotions 15.38
- Race and sports betting 15.39–43
- Slot machines 15.44–49
- Table games 15.50–53
- Understanding the entity and its environment 13.32–34, 13.92

INTERNATIONAL ENVIRONMENT 1.09,**..... 1.17, 14.31****INTERNET GAMING. See online gaming****IT. See information technology****J****JACKPOT PAYOUT, DEFINED 11.06****JACKPOT PAYOUT SLIP, DEFINED 3.23****JACKPOTS. See also slot**

- machines 4.01–10**
- Accounting for 4.08–10
- Background 4.01
- Defined 1.41, 4.01
- Jackpot insurance 11.05–13

JACKPOTS — continued

- Liabilities 3.07, 4.02–07, 4.08
- Payouts 3.23, 11.06
- Revenue 4.08–10, 11.11–13
- Types of 4.03–07

K**KENO**

- Analytical procedures 16.07
- Cash count 15.34
- Cutoff procedures 14.20
- Generally 1.43
- Hold percentage factors 16.09
- Internal control 15.31–34
- Number selection process 15.32
- Wagering controls 15.31
- Winning ticket verification and payment 15.33

L**LAMMER BUTTONS, DEFINED 15.12****LAND-BASED CASINOS 1.07,**
..... Table 1-1 at 1.19**LAWS AND LEGISLATION**

- Auditing considerations 13.112–117
- Federal laws. See specific legislative acts
- Going concern consideration 13.169
- International environment ... 1.09, 1.17, 14.31
- State laws. See state laws and regulations

LAYOUT, DEFINED 1.39**LEASE ARRANGEMENTS ... 5.04, 5.05, 5.06,**
..... 9.09**LEASES STANDARD Appendix I****LIABILITIES. See also costs of gaming;**
guarantees

- Chips and tokens 11.14–18
- Fraud risk in subjective accrued liabilities 13.97
- Governmental gaming entities' allocation 12.09, 12.15–16
- Jackpot 3.07, 4.02–07, 4.08
- Long-term 12.16

LICENSING

- As intangible asset 5.02, 7.03, 11.01
- Related parties consideration 13.42
- Rules of 1.26–28, 1.30
- Start-up costs 7.02, 7.04–11
- Third party licensing arrangements 5.02, 5.08

LIMITED STAKES GAMING 1.20**LOCAL AREA PROGRESSIVE AMOUNT,**
JACKPOTS 4.03, 4.06**LOCAL JURISDICTIONS, TAXES AND FEES**
LEVIED 1.33

LONG-LIVED ASSETS	10.01–21
· Accounting for supporting items	11.27
· To be held and used	10.03
· Cash flow estimates for recoverability testing	10.13–20
· Generally	10.01
· Grouping of	10.07–12
· Retirement obligations	10.02, 10.21
· Summary of literature	10.02
· Triggering events	10.04–06

LONG-TERM LIABILITIES	12.16
------------------------------------	--------------

LOTTERIES

· Accounting	1.14–15
· Cash reconciliations	15.37
· Defined	1.12
· Generally	1.12–16
· Instant ticket controls	15.37
· Internal control	15.35–37
· Network and database security	15.36
· Number selection process	15.35
· Revenue reporting	3.06
· U.S. distribution of	Table 1-1 at 1.19
· Video terminal machines	1.07, 1.14, 3.06, 15.37

LOTTO TICKETS, DEFINED	1.14
-------------------------------------	-------------

LOYALTY AND INCENTIVE

PROGRAMS	6.01–29
· Credits for customers	3.35, 3.40
· Discretionary incentives	3.33, 6.02, 6.03–08, 6.13–16
· Financial statement disclosures	6.29
· Fraud potential in	13.97
· Generally	3.33–42, 6.02–12
· Internal control	15.38
· Match play coupons	3.36–37
· Nondiscretionary incentives	3.33, 6.02, 6.09–12, 6.17–27
· Status-only incentive programs	6.28
· Summary of literature	6.01

M

MAIL CIRCULARIZATION METHOD FOR RECEIVABLES	14.42
--	--------------

MANAGED PROPERTY

· Accounting for	8.16–19
· Financial statements	8.15, 8.16–21
· Relationship to gaming entity	8.01–04, 8.06
· Third party property management	8.01–21, 11.19–23

MANAGEMENT

· Acceptance and engagement	13.05–10
· Fraud consideration communications with	13.92, 13.109–110
· Going concern evaluation	13.168, 13.171–174, 13.177–179, 13.181–182
· Internal control responsibility	15.09

MANAGEMENT — continued

· Legal compliance responsibility	13.112–113
· Override of controls by	13.102
· Representations from	13.152–160
· As responsible party for representations	13.154–157, 13.160

MARKER PLAY, DEFINED	13.97
-----------------------------------	--------------

MARKERS

· Credit controls	14.17, 15.12, 15.14–15
· Cutoff balances	14.17
· Defined	3.15, 14.30
· External confirmation of receivables	14.33, 14.45, 14.46
· International legality of	14.31

MARKETING/PROMOTIONAL EXPENSE. See also loyalty and incentive programs	3.13, 6.05
---	-------------------

MASTER GAME REPORT, DEFINED	3.16
--	-------------

MATCH PLAY COUPONS	3.36–37
---------------------------------	----------------

MATERIAL MISSTATEMENT, RISK OF. See also fraud consideration

· Analytical procedures chosen	13.134
· Auditor's response	13.51, 13.100–102, 13.118–126
· External confirmation of receivables	14.33, 14.36
· Generally	13.12–13
· Internal control	13.55–64, 13.92
· Materiality judgment and	13.26–31
· Related parties	13.42
· Risk assessment procedures	13.15, 13.17–24, 13.32–38, 13.45–54, 13.92–99

MATERIAL WEAKNESS	13.57, 13.162–163
--------------------------------	--------------------------

MATERIALITY

· Assessment of	13.25–31, 13.151
· Written representations from management	13.157

MERGERS AND ACQUISITIONS, INTANGIBLE ASSETS ACQUIRED IN	11.01–04
--	-----------------

METERS, SLOT MACHINE	3.27
-----------------------------------	-------------

MISAPPROPRIATION OF ASSETS	13.88–91
---	-----------------

MISSTATEMENTS. See also material misstatement, risk of

· Evaluation of	13.26, 13.105–107, 13.150–151
· Materiality judgment	13.27–31
· Representations by management	13.152–160
· Understanding the entity and its environment	13.32–38

MONEY LAUNDERING	1.37, 13.116
-------------------------------	---------------------

MONEY LAUNDERING SUPPRESSION ACT OF 1994 13.115

N

NATIONAL INDIAN GAMING COMMISSION (NIGC) 1.10

NATIVE AMERICAN GAMING 1.10–11, 1.37, Table 1-1 at 1.19

NET GAMING REVENUE, DEFINED 3.09–10

NET POSITION 12.08–10

NEVADA 1.01–04

NEW GAMING OPERATION, SPECIAL ALLOWANCE FOR 14.49

NEW JERSEY 1.05

NEW JERSEY CASINO REINVESTMENT DEVELOPMENT AUTHORITY (CRDA) 1.37, Appendix E

NIGC. See National Indian Gaming Commission

NON-BANKED CARD GAMES 1.11

NONAMORTIZED LONG-TERM ASSETS 10.15

NONCASH CONSIDERATIONS AS SALES INCENTIVE. See complimentary

NONDISCRETIONARY INCENTIVE PROGRAMS 6.17–27

- Cash or cash equivalents 6.20–21
- Complimentaries 3.41, 6.22–26
- Defined 3.33, 6.02
- Free play 6.17–19
- Generally 6.09–12
- Noneconomic status offers 6.28
- Type of incentive option 6.27

NONECONOMIC STATUS OFFERS 6.28

NONPROGRESSIVE JACKPOTS ... 4.03, 4.04

NOTES TO FINANCIAL STATEMENTS ... 6.29, 11.27

O

Ol. See other information

ONLINE GAMING

- Auditing considerations 13.67
- Cash accountability 14.23
- Development 1.22
- Generally 1.17, 1.38, 1.46
- State regulation 1.26
- U.S. distribution Table 1-1 at 1.19

OPENERS, DEFINED 3.16

OPINION, AUDITOR'S

- Auditor's responsibility for 13.151
- Further audit evidence to support 13.120
- Generally 13.12–13

OPINION, AUDITOR'S — *continued*

- Inability to arrive at material misstatement conclusion 13.107
- Modifications to 13.63, 13.160
- Other information 13.189
- Required supplementary information ... 13.191

ORAL RESPONSES TO EXTERNAL CONFIRMATION OF RECEIVABLES REQUESTS

..... 14.43–44

OTHER INFORMATION (OI) 13.189

OVERHOLDING VARIANCES, DEFINED 16.06

OVERRIDE OF CONTROLS BY MANAGEMENT 13.102

OWNER/SELLER, DEFINED 5.01

P

PANGUINGUI (PAN), DEFINED 1.40

PAPER CONTROLS 15.03

PARI-MUTUEL BETTING 11.19–21

PARTICIPATION

ARRANGEMENTS 5.01–09

- Background 5.01–03
- Defined 5.01
- Income statement presentation 5.06–09
- Lease criteria 5.05
- Summary of literature 5.04
- Wide area progressive systems 5.03

PAYOUT (PAYOFF)

- Bingo 15.18
- Internal control 15.38
- Jackpots 3.23, 11.06
- Lottery 3.06
- Race and sports betting 15.41
- Slot machine 1.41, 3.21, 15.44

"PEOPLE WATCHING" CHECKS FOR INTERNAL CONTROL 15.05–06

PERFORMANCE MATERIALITY 13.28–30

PHYSICAL SAFEGUARDS, INTERNAL CONTROL 15.04–05

PIT, DEFINED 13.128

PLANNING. See audit planning

PLAYER TRACKING, DEFINED 3.34

PLAYERS CLUBS, DEFINED 3.34

POINT SPREAD IN RACE AND SPORTS BETTING, DEFINED 16.09

POKER

- Analytical procedures for 16.07
- Defined 1.40
- Win-to-drop percentage analysis ... 16.10–12

PPE. See property, plant, and equipment

PREDECESSOR AUDITOR 13.10

PREOPENING AND START-UP COSTS	7.14–15, 8.07–11
PRIVACY, CONSUMER FINANCIAL INFORMATION	1.37
PROFESSIONAL AND AMATEUR SPORTS PROTECTION ACT OF 1992 (PASPA)	1.37
PROFESSIONAL JUDGMENT	13.35
PROFESSIONAL SKEPTICISM	13.51, 13.76–77
PROGRESSIVE JACKPOTS. See also wide area progressive (WAP) systems ...	3.07, 4.03, 4.05–07
PROJECT DEVELOPMENT COSTS	7.12–13
PROMOTIONS. See also loyalty and incentive programs	
· Chips	3.39
· Costs of	3.13, 6.05
· Internal control	15.38
· Promotional allowances	3.41–42
· Slot machine bonus tracking	15.47
PROPERTY, PLANT, AND EQUIPMENT (PPE). See also managed property	
· Asset measurement	9.27
· Fraud risk in	13.85, 13.97
· Guarantees	9.03
· Licensing	7.11
· Long-lived assets	10.02–10, 10.13–18
PROPRIETARY FUNDS	12.16

Q

QUALITY CONTROL	13.05, Appendix H
------------------------------	-------------------

R

RACE AND SPORTS BETTING	
· Analytical procedures	16.07
· Cash count controls	15.42
· Cutoff procedures	14.21
· Equipment	15.39
· Generally	1.45
· Hold percentage factors	16.09
· Internal control	15.39–43
· Legality power shift from federal to state level	1.37
· Online betting	1.22
· Payout controls	15.41
· Segregation of duties	15.43
· U.S. distribution of	Table 1-1 at 1.19
· Wagering process and controls	15.40
RACE BOOK, DEFINED	11.19
RACETRACK FEES	11.19–23
RACINOS	1.07, Table 1-1 at 1.19
RAKE-OFF, DEFINED	1.40

REAL ESTATE. See property, plant, and equipment	
REAL ESTATE MANAGEMENT	7.03
REAUDIT ENGAGEMENTS	13.11
RECEIVABLES, SPECIAL AUDIT OF	14.28–45
· Background	14.28–31
· External confirmation methods	14.32–45
REDEMPTION KIOSK, DEFINED	1.41
REEL CYCLE, DEFINED	4.01
REELS, SLOT MACHINE	1.41
REGULATION AND OVERSIGHT	
· Analytical procedure requirements	16.03
· Audit review	13.34
· Auditing considerations	13.112–117, 13.169
· Capital impairment	12.19, 12.21
· External confirmation of receivables	14.41
· Generally	1.25–37
· Going concern consideration	13.169
· History	1.03–05
· Industry-specific factors for auditor	13.07
· Native American gaming	1.10–11
· Online gaming	1.22
· Operating methods	1.31
· Securities laws for publicly held gaming entities	1.36
· State jurisdiction for	1.08, 1.12
· Wide area progressive jackpots	4.07
RELATED PARTIES	13.41–44
REMOTE ACCESS CONTROLS FOR COMPUTERIZED GAMES	15.30
REQUEST FOR CREDIT OR FILL, DEFINED	14.20
REQUIRED SUPPLEMENTARY INFORMATION (RSI)	13.191–192
RESORTS, GAMING	1.23
RETIREMENT OF ASSETS, OBLIGATIONS FOR	10.21
REVENUE	3.01–42
· Cash. See cash and cash equivalents	
· Casino and casino cage transactions	3.05, 3.14–32
· Cutoff procedures	14.14–22
· Deferred revenue model	6.10–11, 6.19, 6.25–26, Table at 6.26
· Fraud risk in revenue recognition	13.98
· Generally	3.01–13
· Gross gaming revenue	3.07–08, 3.16, 3.19–20, 3.28, 16.06
· Guarantees	9.03, 9.10–11, 9.16
· Immediate revenue model	6.10, 6.12, 6.23–24
· Implementation of revenue recognition standard	Appendix J
· Jackpots	4.08–10, 11.11–13

REVENUE — continued

- Lotteries 1.15, 3.06
- Loyalty and incentive programs 3.33–42, 6.01, 6.06–07, 6.13–14, 6.17–19, 6.20–21
- Native American gaming 1.37
- Net gaming revenue 3.09–10
- Racetrack fees 11.22
- Receivables audit 14.28–45
- Resource flows between gaming entities and governments 12.13–15
- Revenue recognition framework 3.01, Appendix B
- SEC-regulated entities 5.04
- Sharing arrangements. *See* revenue sharing arrangements
- Third party property management 8.05
- Wide area progressive jackpots 4.10

REVENUE SHARING**ARRANGEMENTS 5.01–09**

- Background 5.01–03
- Defined 5.01
- Income statement 5.06–09
- Lease criteria 5.05
- Summary of literature 5.04
- Wide area progressive systems 5.03, 5.09

RIM CREDIT ACTIVITY, DEFINED 15.53**RISKS AND RISK ASSESSMENT**

- Analytical procedures 13.53–54, 13.93
- Audit planning 13.15
- Audit risk 13.12–13, 13.17–22
- Business risk and gaming risk, distinguishing between 3.03, 3.12
- Control risk 13.21, 13.63
- Defined 13.45
- Detection risk 13.17
- Fraud consideration 13.92–102
- Going concern consideration 13.171–172
- Guarantees 9.16–19
- Industry risk factors 13.40
- Inherent risk 13.21–22
- Internal control 13.55–72, 13.92
- Jackpot insurance 11.05–13
- Material misstatement. *See* material misstatement, risk of
- Risk assessment procedures 13.23–24, 13.45–54, 13.92–99, 13.171–172
- Understanding the entity and its environment 13.15, 13.20, 13.23–24, 13.32–38, 13.45–47, 13.49, 13.51–53

RIVERBOAT GAMING MARKETS 1.06, Table 1-1 at 1.19**RSI. *See* required supplementary information****RULES OF GAMES Appendix G****S****SCHEDULE OF CHANGES MADE TO TEXT FROM PREVIOUS EDITION ... Appendix K****SECURITIES ACT OF 1933 1.36****SECURITIES EXCHANGE ACT OF 1934 (THE 1934 ACT) 1.36****SEGMENT REPORTING ... 11.24–26, 12.22, 13.37****SERVICE ORGANIZATIONS 13.69****SERVICE UTILITY APPROACH TO ASSETS FOR GOVERNMENTAL GAMING ENTITIES 12.17, 12.21****SETTLEMENTS OF MARKERS 15.15****SHILL FUNDS, CARD GAMES 15.25****SI. *See* supplementary information****SIGNIFICANT RISKS 13.52****SINGLE MACHINE JACKPOTS, DEFINED 4.03****SLOT BOOTH, DEFINED 3.21****SLOT CLUBS, DEFINED 3.34****SLOT DROP, DEFINED 3.24****SLOT FILLS, DEFINED 3.21****SLOT MACHINE CYCLE, DEFINED 3.21–29****SLOT MACHINES**

- Analytical procedures for 16.07
- Cash count controls 15.45–46
- Cutoff procedures 14.18–19
- Drop boxes 15.46
- Fills and payouts 3.21, 15.44
- Fraud risk in technology 13.97
- Generally 1.07, 1.41–42
- Gross gaming revenue 3.28
- Hold percentage factors 16.09
- Internal control 15.44–49
- Jackpots. *See* jackpots
- Operating cycle 3.21–29
- Payout 1.41, 3.21, 15.44
- Player tracking 15.47
- Promotion and bonus tracking 15.47
- Server based gaming systems 15.49
- WAP systems. *See* wide area progressive (WAP) systems

SOFT COUNT, DEFINED 3.24**SOFTWARE CHANGES FOR COMPUTERIZED GAMES 15.29****SPECIAL AUDITING****CONSIDERATIONS 14.01–52**

- Allowance for doubtful accounts ... 14.47–52
- Branch offices 14.46
- Cage accountability 14.03–13
- Cash balances and revenue cutoff 14.02–06
- Cutoff procedures 14.14–22

SPECIAL AUDITING**CONSIDERATIONS — *continued***

- Drop and count procedures 14.24–27
- Online gaming 14.23
- Receivables 14.28–45

SPECIALISTS, USING WORK OF 13.70,
..... 13.80, 13.145–149

SPORTS BETTING. *See* race and sports betting

START-UP COSTS 7.01–15

- Background 7.01–02
- Licensing 7.02, 7.04–11
- Preopening and start-up 7.14–15
- Project development 7.12–13
- Summary of literature 7.03

STATE LAWS AND REGULATIONS. *See also* lotteries

- Regulation jurisdiction for gaming 1.08,
..... 1.12
- Sports betting jurisdiction 1.37
- Taxes and fees levied 1.33
- Tribal-state compacts 1.10–11
- Types of gaming by state 1.21, 1.22,
..... Table 1-1 at 1.19

STATEMENT OF NET POSITION ... 12.08–10

STATUS INCENTIVE PROGRAMS 6.28

STICKPERSONS, DEFINED 1.39

STIFF SHEET, DEFINED 3.16

STRAIGHT CASH INCENTIVES, DEFINED 3.38

SUBJECTIVE ACCRUED LIABILITIES 13.97

SUBSTANTIAL DOUBT CRITERION, GOING CONCERN CONSIDERATION 13.167–179,
..... 13.181–182

SUBSTANTIVE PROCEDURES 13.125–126,
..... 13.128–129

SUPPLEMENTARY INFORMATION (SI) 12.07, 13.190–192

SYSTEM BASED GAMES 1.42

SYSTEM CONTROLS FOR COMPUTERIZED GAMES 15.27

SYSTEM SUPPORTED GAMES 1.42

T**TABLE GAMES**

- Analytical procedures for 16.07
- Cash count procedures 15.52
- Cutoff procedures 14.16–17
- Fills and credit controls 15.50
- Generally 1.39
- Hold percentage factors 16.09
- Internal control 15.50–53
- Table inventories 15.51

TABLE GAMES — *continued*

- Transactions generally 3.14–20
- Win-to-drop percentage analysis ... 16.10–12

TABLE GROSS GAMING REVENUE, DEFINED 3.16

TABLE INVENTORY, DEFINED 3.16

TAXES

- Deferred income taxes for casinos 11.28
- Taxes and fees levied 1.33–35

TERMS OF ENGAGEMENT 13.05–10

TESTING

- Asset recoverability 10.13–20
- Branch office controls 14.46
- Cage accountability 14.07–13
- Closing process 13.126
- Gross gaming revenue 16.06
- Internal control 13.64, 13.122–125,
..... 13.128–129, 13.134

THEORETICAL HOLD PERCENTAGES ... 3.27

THIRD PARTY LICENSING

ARRANGEMENTS 5.02, 5.08

THIRD PARTY PROPERTY

MANAGEMENT 8.01–21

- Background 8.01–04
- Costs prior to management agreement 8.07–11
- Disclosures 8.15, 8.20–21
- Existing management agreement costs 8.12–14
- Financial statement classification of amounts paid 8.15
- Managed property's accounting responsibilities 8.16–19
- Racetrack fees 11.19–23
- Summary of literature 8.05–06

THOSE CHARGED WITH GOVERNANCE

- Acceptance and engagement 13.05–10
- Communication with 13.109–110,
..... 13.161–166, 13.181
- Fraud consideration 13.92
- Legal compliance responsibility 13.112–113
- Written representations from ... 13.152–160

TICKET IN, TICKET OUT (TITO), DEFINED 1.41

TICKETS

- Keno 15.31–32, 15.33
- Lottery 1.14, 15.37
- Slot machine 1.41, 3.25

TIME BUY-IN, DEFINED 1.40

TIMING OF AUDIT

PROCEDURES 13.127–130

TITO. *See* ticket in, ticket out

TOKENS, DEFINED. *See also* chips 3.31

TOLERABLE MISSTATEMENT/TOLERABLE ERROR, DEFINED 13.28

TOURNAMENTS, GAMING15.26
 TRACK ENTITY, DEFINED 11.19
 TRACK FEES 11.19–23
 TRADEMARKS AS INTANGIBLE
 ASSETS11.02
 TRIBAL-STATE COMPACTS 1.10–11
 TRIGGERING EVENTS 10.04–06

U

UNANNOUNCED AUDIT
 PROCEDURES14.50–52
 UNDERHOLDING, DEFINED 16.06
 UNDERSTANDING THE ENTITY AND ITS
 ENVIRONMENT 13.32–40
 · Audit context 16.01–12
 · Audit planning13.15
 · Discussion among audit team ... 13.39, 13.78
 · External confirmation of receivables 14.37
 · Generally 13.35–36
 · Industry risk factors 13.40
 · Internal control 13.32–34, 13.56–62,
 13.92
 · IT considerations 13.66–67
 · Risk assessment of material
 misstatement 13.15, 13.20, 13.23–24,
 13.32–38, 13.45–47, 13.49,
 13.51–53
 UNIFORMS11.27
 UNLAWFUL INTERNET GAMBLING
 ENFORCEMENT ACT OF 2006
 (UIGEA) 1.22
 USA PATRIOT ACT OF 20011.37, 13.115
 USEFUL LIFE OF ASSET10.17
 USER CONTROLS FOR COMPUTERIZED
 GAMES 15.28

V

VIDEO LOTTERY TERMINALS1.07, 1.14,
 3.06, 15.37
 VOUCHER-OPERATED GAMING
 DEVICES14.19

W

WAGERING ACCOUNTS FOR
 CUSTOMERS 3.26, 15.21
 WAGERING TRANSACTIONS 3.17, 15.31,
 15.40
 WAGERING VOUCHER (TICKET) ... 1.41, 3.25
 WAP SYSTEMS. *See* wide area progressive
 (WAP) systems
 WEIGH COUNT, DEFINED 15.46
 WIDE AREA PROGRESSIVE (WAP) SYSTEMS
 · Controlling 15.48
 · Defined 1.41, 4.03
 · Income statement 5.09
 · Revenue sharing arrangements 5.03, 5.09
 · Rules of operation 4.06–07
 WIN, DEFINED 3.05, 3.07, 16.07
 WIN-TO-DROP PERCENTAGE
 ANALYSIS16.10–12
 WORKING PAPERS/WORKPAPERS,
 DEFINED 13.138
 WRAP COUNT, DEFINED 15.46
 WRITEOFFS OF ITEMS 14.40, 15.15
 WRITTEN
 REPRESENTATIONS 13.152–160
 Y
 YEAR-END AUDIT TIMING 13.130

