



Risks of material misstatement: Gaming

Note: This practice aid is intended to help auditors identify risks of material misstatement (RMM) in accordance with AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. This publication is an *other auditing publication* as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, Professional Standards). Other auditing publications have no authoritative status; however, they may help you, as an auditor, understand and apply certain auditing standards.

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Instructions

AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires that the auditor identify and assess the risks of material misstatement (RMM) at the financial statement level and relevant assertion level for classes of transactions, individual account balances, and disclosures to provide a basis for performing further audit procedures. RMM includes both inherent risk and control risk.

To aid auditors in meeting this requirement, this document includes information that could be useful in assessing RMM in the gaming industry. **These examples do not include all examples of RMM that could apply or be relevant.**

Refer to the AICPA's [Audit and Accounting Guide: Gaming](#) for further information on auditing clients in the gaming industry.

Fraud

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.

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:

- Property and equipment accounting
- Bad debt reserves
- Subjective accrued liabilities
- Incentives provided to customers
- Manipulation of slot technology

Inherent risk

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

Internal control

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. Typical gaming internal control considerations relate to:

- Granting and Control of Credit
 - Approval of Credit Lines and Maintenance of Credit Files
 - Issuance of Credit
 - Recording of Credit Transactions
 - Custody of Markers
 - Writeoffs and settlements
- Bingo
 - Card sales
 - Number selection
 - Payouts
 - Funds
- Cage
 - Customer deposits
 - Customer wagering accounts
 - Accountability
- Card Games
 - Card room funds
 - Drop and count
 - Shills
- 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
 - System controls
 - User controls
 - Software changes
 - Remote access
- Keno
 - Keno wagering

- Number selection
 - Winning ticket verification and payment
 - Keno funds
- Lotteries
 - Number selection
 - Network and database security
- Race and Sports Book (for Computerized Systems)
 - Equipment
 - Race and sports wagering
 - Race and sports payouts
 - Race and sports funds
 - Employee segregation of duties
- Slot Machines
 - Fills and payouts
 - Slot department funds
 - Count procedures (applies to both scheduled and unscheduled counts)
 - Computerized player tracking, promotional accounts, promotion, and bonusing systems
 - Wide area progressive slot machines
 - Server based gaming systems
- Table Games
 - Fills and credits
 - Table inventories
 - Count procedures (applies to both scheduled and unscheduled drops and counts)
 - Rim play

Risks related to accounting estimates

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

Understanding the client

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.

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