

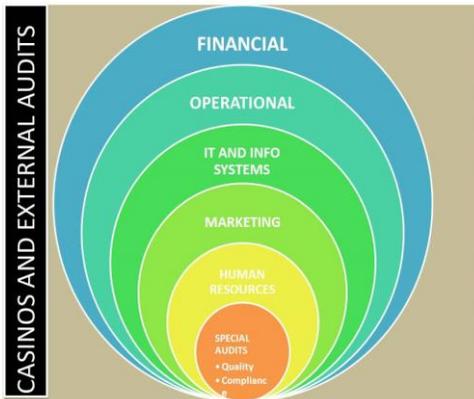


# CASINO AUDITS : Not all are created equal

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## RUN, RUN,....AUDITORS ARE COMING!!

It is fair to say that we have grown with an adverse and negative concept about audits. The simple mentioning of the **WORD 'AUDIT'** triggers in our minds images of dark suited gentlemen with



briefcases, who come and ask lots of questions and requested documents with the intention of finding deficiencies, faulty books and records and procedural violations. Dark images of documents, adding machines and pens over desks being thoroughly reviewed, or the *always scrutinizing eyes of the men looking at our operations from the corner and talking like if hidden secrets had been found*. Finally, the terrifying audit report, the unpaid taxes assessment and the calls from headquarters “What is going on down there?”

These traditional images are good for Hollywood movies and storytelling but nothing close to modern understanding and practicing of the auditing tasks. Today, auditors are considered a business partner and not policemen. As such, casinos can extensively benefit from their services which, too frequently, are only considered as a compliance tool or when required by circumstances. No, **AUDITS ARE NOT A NECESSARY EVIL BUT A DEVELOPMENT AND STRATEGIC TOOL**.

## DIFERENT TYPES OF AUDITS: NOT ALL AUDITS ARE MADE EQUAL

All audits are independent and systematic studies of relevant data to determine how appropriate the level of compliance is to procedures, standards, budgets, goals or regulations. In general, the most known audit types in the casino industry are **FINANCIAL AUDITS AND OPERATIONAL AUDITS**. In recent years, we have expanded our recognition of the importance and value of Marketing Audits, IT Audits, HR or Performance Audits, quality audits, forensic audits, energy audits, environmental audits, etc.

Of course, they overlap and each audit will deal at different levels with the data most properly handled by others. It is common to find on their reports and recommendations frequent and valuable references to and between each type. After all, a casino business has to be assumed as an integrated effort and not the sum of individual departments. Well done financial audit will always refer to internal controls and aspects of the operation and will always have to consider IT Resources, Information access and distribution, etc. Operational audits will not only stop at verifying compliance of internal controls and other external regulations but, as described on its definitions, will have the main objective of optimizing task to make them more efficient, therefore, minimizing costs, optimizing the use of resources (including and most importantly HR) and will definitively touch base

with IT Resources and Information flow (Player Tracking, Management Systems, Slots and Table Game Accounting,...). Marketing Audit, maybe the least familiar to many of us but it has acquired great relevance in recent years.

Keeping in mind that they are all interconnected, let's talk about other types of audits which could be less familiar to many of us. Let's start with Operational Audits.

### **OPERATIONAL AUDITS: DEFINITION**

**THE INSTITUTE OF INTERNAL AUDITOR (IIA) DEFINES OPERATIONAL AUDIT AS A SYSTEMATIC PROCESS OF EVALUATING AN ORGANIZATION'S EFFECTIVENESS, EFFICIENCY AND ECONOMY OF OPERATIONS UNDER MANAGEMENT'S CONTROL AND REPORTING TO APPROPRIATE PERSONS THE RESULTS OF THE EVALUATION ALONG WITH RECOMMENDATIONS FOR IMPROVEMENT.** They continue describing it as "a more comprehensive form of an internal audit and, although financial data may be used, primary sources of evidence are actual operations procedures and how well they match policies established by the organization. While financial audits tend to be past-oriented and work with results of past periods of activities, operational audits are future-oriented. It tests how efficient and effective gaming operations are, which ultimately boosts revenue and profits".

External or internal experts may perform the review, based on the needs of the business. This process has some disadvantages, such as potentially high cost, but it also offers advantages, such as new perspectives and increased risk awareness. These professionals are not otherwise associated with the businesses they audit, so they can provide a fairly objective opinion. Stakeholders often prefer using their services to internal auditors to get information because of this lack of bias, but hiring an outsider usually is more expensive. Relying on an employee to perform the job carries the risk that the ending figures or analysis won't be entirely accurate, because an individual sometimes gets a bonus or pay increase based on how good the results are. On the same token, some internal audit departments are not quite as independent as they need to be and constraints on their findings and reports are sometimes self-imposed. Also, management is so close to the operation that could neglect to adequately see what lies behind and improvement areas. Finally, use of internal resources could also be limited by time and availability as a result of their importance to day-to-day operations.

### **WHY IS IT IMPORTANT TO YOU?**

What normally happens is that management gets a reasonable idea of how healthy their gaming operations are based on financial audits, daily, weekly or monthly reports and their casino management system. Financial and operational performance as expressed by reported numbers and KPIs could then signal to specific areas which are not performing or could perform better when compared to budget, guidelines, benchmarks and budgets.

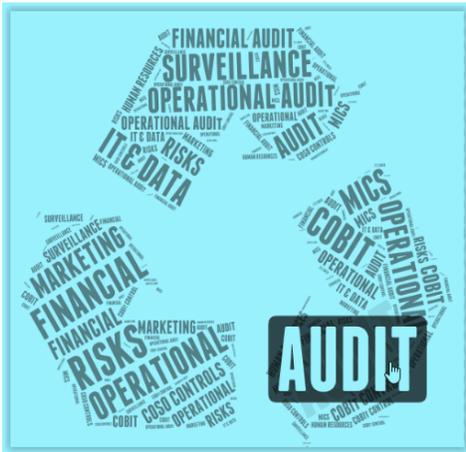
As we know, CASINOS ARE A FAST PACE OPERATION WITH GROWING COMPETITION AND HIGHER DEMAND FOR “VALUE ADDED SERVICE AND ENTERTAINMENT” BY PLAYERS. It is normal that, in the heat of a demanding and absorbing routines, casino management would need to turn to independent Operational Audits for further research and explanation of those resulting financial indicators and to get a better and clearer picture. The results not only show controls and procedures weaknesses but also significant areas of improvements.

To summarize benefits of Operational Audits:

- ✓ PROVIDES SUPPORTING AND EXPANDED DOCUMENTATION OF FINANCIAL AUDITS
- ✓ HELPS IDENTIFIED WEAKNESSES IN THE CONTROLS AND PROCEDURES OF THE OPERATION
- ✓ SIGNALS POTENTIAL AREAS FOR IMPROVED EFFICIENCY AND PROFITABILITY
- ✓ HELPS MANAGEMENT TO BETTER UNDERSTAND ROOTS OF PROBLEM AREAS BETTER THAN JUST LOOKING AND FINANCIAL STATEMENT AND DAILY REPORTS.
- ✓ PROVIDES NEW AND FRESH PERSPECTIVES
- ✓ HELPS TO IDENTIFY AREAS TO MINIMIZE USE OF RESOURCES

## **SIGNIFICANT RISKS, MAIN APPLICABLE AREAS AND TOOLS**

It is assumed that most casino operations have extensive documentation regarding controls and procedures but, many times, lack of interest, non-compliance or non-reinforcement, changes in operations, developments and evolution, among other reasons, cause these manuals and guidelines to become “books on shelves”, obsolete and non-applicable. Day to day operations also lead into their own procedures which, depending on the training schedule and management attitude, pass from one employee to another and, at worst circumstances, end up causing major distortion and allowing “weak control areas” abused by both the internal (employee) and external clients(customers). This is very common at small to mid-size operations under jurisdictions which are very poorly regulated and/or single and family owned casinos.



Although each area has specific risks and auditing steps, there are several common objectives for casinos which can be summarized as follow : i) *Cash and assets Controls*; ii) *Adequate surveillance for all transactions*; iii) *Independent reviews of transactions performed timely* ; iv) *Review access to all IT systems*; v) *Ensure personnel has an adequate knowledge of operations*; vi) *Proper Accounting and Reporting processes and tools*; vii) *Compliance to jurisdictional regulations and programs*; viii) *Ensure actual procedures in operation match the Internal Control and Procedures Manuals and satisfactorily*

*comply with appropriate MICS; ix) Human Resources and appropriate segregation of duties; x) Evaluate how well marketing plans and strategies adapt to the casino culture, brand and needs.*

We all know “cash is king” in the casino industry but increasing needs for **COMPLIANCE, SECURITY AND PROPER MANAGEMENT OF RISK AREAS HAS HELPED EXPAND AWARENESS FOR OPERATIONAL AUDITS**. It comes to no surprise then that the main areas of application for Operation Audits are: Casino Cage Operations, Slots Club and Loyalty Rewards Programs, Table Games Procedures and Slots Operations. There are 3 other departments which have become so significant that special procedures and audit techniques have been developed from the general Operational Audit standards: Marketing, IT/Data and Management Information Systems and Human Resources policies and Procedures. Some professionals have added surveillance as an area of importance to try to answer the question: Who audits surveillance?.

More specifically, here are some areas of interest where Operational Audits and its techniques can be highly beneficial : *MICS and Compliance, Cash Handling and Reporting (“follow the money” programs), Game Protection, Operational Analysis and Research (Table Games, Slot Machines, Hotel-Casino relationship, Amenities---), Floor and Revenue Optimization(Inc. Yield Management), Secret Shopper, Market Research and Intelligence (links to Marketing Audits), Hotel-Casino Relations, Entertainment and other Gaming Areas of Support (Lounges, Sport book, Bing Parlors,...).*

## **BORROWED BUT USEFUL TOOLS**

Although it is normal and expected to relate operational audits and research with production industries, there is no limitation to apply its techniques and methodology to casinos and gaming operations as a whole since service is to be considered a product and, recently, other non- gaming operations have become very significant to the overall productivity of corporations.

No matter what industry type we address, operations managers are responsible for ensuring that business operations are efficient, both in terms of use of resources as well as customer services and increased productivity. Management can use an array of tool available all of them, based on the premise of all members of an organization participating in improving processes, products, services and the culture in which they work.

In this area, the casino industry benefits from tools originally created to be used in the manufacturing industry but fully applicable to gaming. To mention the most well-known ones: SIX SIGMA, Theory of Constraints (TOC), Lean (aka Elimination of unnecessary costs and resources), Benchmarking, a technique that allows a manager to compare metrics, such as quality, time, and cost, across an industry and against competitors and Total Quality Management (TQM) which Simply put, it is a management approach to long-term success through customer satisfaction, Operations Research techniques and methods and, of course, , , . Of course, we could not end this short list of main tools

without mentioning the extensive and comprehensive areas of **Business Analytics and Intelligence** which most of the current Management Systems include as part of their suits.

In essence, it is important that we see audits as development tools and auditors as business partners. It is also important that we look into other forms of auditing beyond the traditional finance and accounting audits, After all, numbers come from somewhere and always signal areas where controls and procedures can be improved.