

*National Indian Gaming Association
Trade Show and Convention March 2007*

Improving Effectiveness of Internal Audits

Presenters:

Charles Russell, Senior Manager
Krista Carey, Manager

Improving Effectiveness of Internal Audits

Agenda

Part 1 – Control Environment

Part 2 – Performing an Effective Internal Audit

Part 3 – Selected Accounting and Auditing NIGC MICS Steps

Part 4 – Questions ?

Part 1 Control Environment

Establishing tone at the top both at Tribal and Management Level

❖ Code of Conduct

- ✓ **Integrity and Ethical Values** - Management should convey the message that integrity and ethical values cannot be compromised, and employees must receive and understand that message. Management should continually demonstrate, through words and actions, a commitment to high ethical standards.
- ✓ **Every organization has a standard of conduct, whether it knows it or not** - One way or another, explicitly or implicitly, every organization communicates its values, acceptable criteria for decision-making, and its ground rules for behavior. An increasing number of organizations realize the importance and value of explicitly communicating their values and guiding principles in a published code of conduct or ethics.

Part 1 Control Environment

❖ Comprehensive Policies and Procedures

- ✓ Helps ensure compliance with NIGC and Tribal MICS.
- ✓ Establishes expectations of job performance.
- ✓ Provides a framework of accountability.

☐ Best practice tips for policies and procedures:

- ✓ Management and employees should have easy access to current policies and procedures. Consider web based or server access to policies and procedures.
- ✓ Include references to NIGC and/or Tribal MICS both in the body of the written system and in an index or appendix to system. (See Examples 1 & 2) [EX. 1](#) [EX. 2](#)
- ✓ Establish a formal framework to make changes to policies and procedures including authorized approvers and time frame of approval process.
- ✓ Indicate effective date of policies and procedures on every page in written internal controls.
- ✓ Include examples of documentation/forms to be used in performance of approved procedures e.g. checkout sheets, fill and credit slips etc.
- ✓ Employees should receive ongoing training on written policies and procedures commensurate with their job responsibilities. Consider at least annual sign-off from employees that they have received training.

Part 1 Control Environment

- ❖ Management's responses to breaches in ethical standards and noncompliance with policies and procedures.
 - ✓ In order for the control environment to be effective, there must be consequences to violations including additional training and education and disciplinary action where appropriate.
 - ✓ Consider use of self reporting of exceptions noted by accounting/auditing personnel.

Part 2 Performing an Effective Internal Audit

Importance of Independence of Internal Auditors

- ❖ All internal audit activities should remain free from influence by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of an independent and objective mental attitude necessary in rendering reports.
- ❖ Internal Auditors should have no direct operational responsibility or authority over any of the activities they review. Accordingly, they shall not develop nor install systems or procedures, prepare records, or engage in any other activity which would normally be audited.

Part 2 Performing an Effective Internal Audit

Writing and communicating exceptions

❖ Case study of exceptions

✓ Key components of exceptions:

- Clearly state the basis for the exception e.g. MICS or TICS reference.
- Indicate how the exception was discovered (i.e., interview with employee on (MM/DD/YY), observation on (MM/DD/YY), detail testing on (MM/DD/YY), etc.).
- If the exception was discovered through detail testing, indicate the sample size examined (i.e., number of days reviewed, number of forms reviewed, etc.) and the time period from which the sample was selected (i.e., second half of 200X).
- Indicate recurring exceptions either noted by Internal Audit or external CPA.
- Consider preparing a standard template to capture the relevant components of an exception (See Examples 3 & 3A). [EX. 3](#) [Ex.3A](#)

Part 2 Performing an Effective Internal Audit

Interpreting exceptions

- ❖ Pervasive exceptions
 - ✓ Factors to consider: magnitude of exception, error rate and repeat findings.
- ❖ Isolated exceptions
- ❖ Relative risk
 - ✓ Consider use of Summary of Findings to communicate exceptions to governing bodies that show relative risk rating of each finding – (See Example 4 & 4a) [EX. 4](#) [EX.4a](#)

Increasing management's involvement through holding formal exit meetings

- ❖ Who should attend exit meetings?
 - ✓ General Manager.
 - ✓ Department Head.
 - ✓ Controller/Director of Finance.
 - ✓ Internal Audit Manager/Director.
 - ✓ Internal Audit Senior.

Part 2 Performing an Effective Internal Audit

- ❖ Use of draft report to communicate preliminary findings.
 - ✓ Provides management opportunity to investigate preliminary findings prior to formal exit meetings.
 - ✓ Allows for timely communication of findings before formal report is issued.
 - ✓ Ensures meeting of the minds on findings.

- ❖ Management's responses for corrective action to be taken on exceptions noted
 - ✓ Management responses should be reflective of action taken or to be taken including memos issued to employees; changes in procedures etc.
 - ✓ Wherever possible, responses for corrective responses should come from management and should not be generic responses from Controller/Director of Finance unless applicable to their department.

Part 2 Performing an Effective Internal Audit

Performing effective walkthroughs

- ✓ Document who inquiries were made of for each question on checklist as applicable. (See Example 5) [EX. 5](#)
- ✓ Keep copies of documents examined during walkthrough or add explicit notes on compliance checklist describing documentation examined. (See Example 5) [EX. 5](#)
- ✓ Vary personnel who inquiries are made of.
- ✓ Vary shifts when walkthroughs are performed.

Following up on prior exceptions

- ✓ Follow up within 6 months of notification of findings 542.42(b)(2).
- ✓ Consider quarterly follow up on exceptions cited in previous quarter, particularly higher risk findings.
- ✓ Consider management's responses for corrective action.

Part 2 Performing an Effective Internal Audit

Sample testing

- ✓ **At a minimum follow NIGC worksheet sampling guidance.**
- ✓ **Perform risk assessment:**
 - **Opportunities for theft.**
 - **Segregation of duties.**
 - **Nature of control.**
 - **Frequency of times control is performed – daily, multiple times a day, weekly, monthly, quarterly, annually.**
 - **Add element of unpredictability into testing.**

Part 3 Selected Accounting and Auditing NIGC MICS Steps

Gaming Machines – Selected NIGC MICS

❖ Investigating meter to drop variances

- ✓ 542.13 (m)(6) For each drop period, accounting/auditing employees shall compare the bill-in meter reading to the total bill acceptor drop amount for the period. Discrepancies shall be resolved before the generation/distribution of gaming machine statistical reports.
- ✓ 542.13 (m)(7) Follow-up shall be performed for any one machine having an unresolved variance between actual currency drop and bill-in meter reading in excess of an amount that is both more than \$25 and at least three percent (3%) of the actual currency drop. The follow-up performed and results of the investigation shall be documented, maintained for inspection, and provided to the Tribal gaming regulatory authority upon request.

Part 3 Selected Accounting and Auditing NIGC MICS Steps

Gaming Machines – Selected NIGC MICS *(continued)*

- ❖ Common pitfalls when investigating variances.
 - ✓ Assuming that difference is due to timing differences without understanding cause of timing differences.
 - ✓ Having slot department exclusively investigate variances.
 - ✓ Lack of skepticism.
 - ✓ Lack of understanding of underlying slot system reports.
 - ✓ Poor documentation of variances including follow up.
- ❖ Documentation of investigations and results of such investigations.
 - ✓ Create a standard form to document investigations. (See Example 6) [EX. 6](#)
 - ✓ Document machine number; drop date; meter amount; actual amount; variance.
 - ✓ Retain copies of documentation to support conclusion.

Part 3 Selected Accounting and Auditing NIGC MICS Steps

Gaming Machines (*continued*)

- ❖ Investigating significant statistical variances between theoretical hold percentages and actual hold percentages.
 - ✓ 542.13(h)(18) For those machines that have experienced at least 100,000 wagering transactions, large variances (three percent (3%) recommended) between theoretical hold and actual hold shall be investigated and resolved by a department independent of the gaming machine department with the findings documented and provided to the Tribal gaming regulatory authority upon request in a timely manner.
- ❖ Consider using standard documentation for investigation of significant variances (See Example 7) [EX. 7](#)

Part 3 Selected Accounting and Auditing NIGC MICS Steps

- ❖ Integrity of slot statistical reports.
 - ✓ Access to system data.
 - ✓ Authorization and documentation of adjustments.
 - ✓ Business intelligence.
 - ✓ Accounting/audit personnel play a vital role in ensuring integrity of data through performing thorough daily audits and testing theoretical hold % used in statistical reports.
 - ✓ EPROM controls and testing.
 - ✓ Reconciliations of net win per statistical reports and general ledger.
 - ✓ Reconciliations of jackpot/tickets paid per cage and per statistical reports.

Part 4 Questions ?

Contact Information:

Charles Russell

PricewaterhouseCoopers LLP

charles.russell@us.pwc.com

(702) 691-5431

3800 Howard Hughes Parkway

Suite 650

Las Vegas, NV 89169

Krista Carey

PricewaterhouseCoopers LLP

krista.carey@us.pwc.com

(702) 691-5410

3800 Howard Hughes Parkway

Suite 650

Las Vegas, NV 89169

© 2007 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP (a Delaware limited liability partnership) or, as the context requires, other member firms of PricewaterhouseCoopers International Ltd., each of which is a separate and independent legal entity.
*connectedthinking is a trademark of PricewaterhouseCoopers LLP.



NIGA Conference Example 2

ABC TRIBAL CASINO
SYSTEM OF INTERNAL CONTROLS
SECTION 2 GAMING MACHINES

Part 4 - Jackpot Payouts:

Jackpots are controlled through an on line monitoring system.

Jackpot payouts, gaming machine fills, short pays and accumulated credit payouts documentation contain the following informations:

(i) Date and time; **(542.13(d)(i))**

(ii) Machine number; **(542.13(d)(ii))**

(iii) Dollar amount of cash payout or gaming machine fill (both alpha and numeric) or description of personal property awarded, including fair market value. Alpha is optional if another unalterable method is used for evidencing the amount of the payout; **(542.13(d)(iii))**

(iv) Game outcome is not required as a computerized jackpot/fill system is used; **(542.13(d)(iv))**

(v) Preprinted or concurrently printed sequential number; **(542.13(d)(v))** and

(vi) Signatures of at least two employees verifying and witnessing the payout or gaming machine fill **(542.13(d)(vi))**.

NIGA Conference Example 3

**ABC TRIBAL CASINO
EXCEPTION DOCUMENTATION**

Department	Slots
Date of discovery	3/25/2007
MICS/TICS Ref	542.13(d) (vi)

Prepared by:	J Auditor
Reviewed by:	S Auditor

How was exception discovered (check all that apply)?

Interview	N/A
Observation	N/A
Detailed Testing	X

If exception discovered by Interview, provide the following additional information

Person interviewed	N/A
Date interviewed	N/A
Shift interviewed	N/A

If exception was discovered through Observation, provide the following additional information

Date	N/A
Employee(s) observed	N/A
Time	N/A
Shift	N/A
Other	N/A

If exception was discovered through Detailed Testing, provide the following additional information

Sample size	60
Test date (s)	2/20/2007
Number of exceptions	2
Error rate	3%
Slip #	125644
Slip #	125645
Slip #	n/a
Slip #	n/a
Slip #	n/a

Note: Attach list if more than 5 exceptions noted

Indicate if exception is recurring

Yes	X
No	

Description of exception(s) noted:

Based upon our testing of 60 jackpot slips for February 20, 2007, we noted two (2) instances where the second signature was missing on the jackpot slip.

Other Details

Internal audit provided copies of jackpot slips to Controller and Director of Slots on March 26, 2007. Both were in agreement as to the nature of the exception. These exceptions will be included in preliminary report that will be discussed during exit conference. Management to provide responses to corrective action at such meeting.

Regulation 542.13 (d)(vi) requires that jackpot payouts and gaming machine fills documentation include the signatures of at least two employees verifying and witnessing the payout or gaming machine fill.

Per examination of 60 jackpot slips dated February 20, 2007, it was identified that slips 125644 and #125645 were missing a second signature.
(Repeat finding from September 2006 Slot Report)

**NIGA CONFERENCE
EXAMPLE 4**

**ABC TRIBAL CASINO
FINDINGS SUMMARY
AUDIT NAME**

ABC TRIBAL CASINO FINDINGS SUMMARY

Overall Audit Rating – 3

Index to Audit Area Ratings

Above Satisfactory - 3

- No exceptions were noted.

Action: Property management is taking the appropriate action at this time.

Satisfactory - 2

- Minimal exceptions were noted. Although exceptions were noted, there was reasonable likelihood that the Regulations, internal controls and company policies and procedures were in place to minimize fines, penalties and/or loss of revenue.

Action: Increased property management involvement is recommended.

Unsatisfactory - 1

- Significant exceptions were noted. Lack of adherence to the Regulations, internal controls and/or company policies and procedures was noted, which most likely would result in fines, penalties and/or a loss of revenue.

Action: Immediate corporate management attention is recommended.

ABC TRIBAL CASINO FINDINGS SUMMARY

Index to Individual Finding Ratings



No finding (no exception noted) or insignificant finding (an exception to the Regulation or internal controls may have been noted).



This is not a significant finding. Although an exception was noted, there was a reasonable likelihood that the Regulation, internal controls and company policies and procedures were in place to minimize fines, penalties, and/or loss of revenue.



Significant exception to Regulation, internal controls and/or company policies and procedures was noted, which would likely result in fines, penalties, and/or a loss of revenue.

ABC TRIBAL CASINO FINDINGS SUMMARY

There were no exceptions identified.

Risk Rating

Low - - - High		
█		

**NATIONAL INDIAN GAMING COMMISSION
MICS AUDIT CHECKLIST
GAMING MACHINES (GM)**

#	MICS QUESTION	YES	NO	W/P REF	MICS	COMMENT
	Inquiries made of: ABC Tribal casino J Slotguy, Slot Floor person (JS) M Jackpot, Slot Supervisor (MJ)					
(a) Standards for computerized gaming machine systems.						
1.	For all computerized gaming machine systems, is a personnel access listing maintained, which includes at a minimum: (Review supporting documentation) Employee name or employee identification number (or equivalent)?	_E	___	___	542.13(a)(3)(i)	Examined system access listing to the Acers slot system on March 2, 2007. Listing contained employee name and employee number
2.	For all computerized gaming machine systems, is a personnel access listing maintained, which includes at a minimum: (Review supporting documentation) Listing of functions employee can perform or equivalent means of identifying same?	E&I	___	___	542.13(a)(3)(ii)	Examined system access listing to the Acers slot system on March 2, 2007. Listing contained access codes that equate to particular functions in the system. Also inquired of MJ who provided listing from system defining the access codes.
(d) Jackpot payouts, gaming machines fills, short pays and accumulated credit payouts standards.						
3.	For jackpot payouts and gaming machine fills, does the documentation include the following information: (Examination of records-complete Jackpot-Payout Fill worksheet) Date and time?	_E_	___	___	542.13(d)(1)(i)	Completed NIGC Worksheet. See external file 8500-1. All slips tested contained date and time designations.
4.	For jackpot payouts and gaming machine fills, does the documentation include the following information: (Examination of records-complete Jackpot-Payout Fill worksheet at question 3 above.)	E_	___	___	542.13(d)(1)(ii)	Completed NIGC Worksheet. See external file 8500-1. All slips tested contained machine number.

NIGA CONFERENCE EXAMPLE 6

**ABC TRIBAL CASINO
GAMING MACHINES
INVESTIGATIONS INTO UNRESOLVED DROP TO METER VARIANCES
NIGC MICS 542 (13)(m)(6) and (7)**

Slot Auditor	Susan Doe
---------------------	-----------

Drop date	12-Mar-2007	Meter Amount	\$ 3,850.00
Machine #	3456	Actual Count	\$ 3,500.00
Denomination	\$1.00	Variance in \$s	\$ (350.00)
Location	BK 25	Variance in %	-9.09%

Investigation (check all that apply):

1	<input checked="" type="checkbox"/>	Machine will be dropped on next cycle to see if variance reverses due to timing difference.
2		Dispatch slot technician to machine to test bill-in meter accompanied by auditing.
3		Contacted _____ in surveillance department and requested that surveillance secure surveillance tape for unusual activity.
4		Contacted _____ in Gaming Commission and requested that they test physical access to machine (s) number(s) _____.
5	<input checked="" type="checkbox"/>	Run bad meter report.
6	<input checked="" type="checkbox"/>	See if emergency drops were performed during drop cycle.
7		Were there any documented complaints from customers regarding functioning of meters?
8		Did drop team have unidentified drops i.e. drops unassigned to machines.
9		Review system exception reports for inappropriate access to machine(s).
10		Review historical hold % versus theoretical % for unusual trends.
11		Other investigations:

Follow up (check all that apply):

1	<input checked="" type="checkbox"/>	Machine dropped on next cycle and variance reversed. No exception noted.
2		Slot technician _____ tested bill in meter accompanied by accounting/auditing and
3		Contacted _____ in surveillance department and requested that surveillance
4		Results of Gaming Commission inspection of physical access to machines.
5	<input checked="" type="checkbox"/>	No exceptions noted on bad meter report.
6	<input checked="" type="checkbox"/>	Review documentation for emergency drops. Emergency drop performed at 3:00pm, but drop proceeds included in total drop.
7		No complaints from customers noted.
8		There were no unassigned machines identified during drop .
9		No access to machines other than scheduled drop time.
10		No unusual trends noted in review of actual versus theoretical hold %
11		Other follow up:

Documentation (check all that apply):

1	<input checked="" type="checkbox"/>	Retain copies of follow up drop/meter variance reports
2		Retain correspondence from slot tech and document accounting/auditing's involvement in
3		Document communications from Surveillance Dept.
4		Document communications from Gaming Commission re physical access to machines
5	<input checked="" type="checkbox"/>	Retain bad meter report
6	<input checked="" type="checkbox"/>	Retain emergency drop documentation, if applicable
7		Retain copies of customer's complaints, if applicable
8		Retain copy of slot drop report showing unassigned drop, if applicable
9		Retain copies of system exception reports examined
10		Retain copy of statistical report
11		Retain other documentation as deemed applicable

Note: If reports can be rerun from slot system there is no need to retain physical copies

Other comments:

Conclusion:

Based upon follow up meter readings on next drop cycle, offsetting variance of \$350 noted.
No exception noted.

Signed: _____
Dated: _____

NIGA CONFERENCE EXAMPLE 7

**ABC TRIBAL CASINO
GAMING MACHINES
INVESTIGATIONS INTO >= 3% VARIANCES BETWEEN THEORETICAL VERSUS ACTUAL
NIGC MICS 542 (13)(h)(18)**

Slot Auditor: Susan Doe

			MTD	YTD	LTD
Month	March 2007	Actual Hold	4.30%	5.80%	8.40%
Machine #	3456	Theoretical Hold	8.70%	8.70%	8.70%
Denomination	\$1.00	Variance in %	4.40%	2.90%	0.30%
Location	BK 25	Coin-In	250,000	780,000	3,000,000

Investigation (check all that apply):		
1	<input checked="" type="checkbox"/>	Examine current theoretical worksheets from manufacturer and compare theoretical hold % in slot statistical report.
2	<input checked="" type="checkbox"/>	Run bad meter report.
3	<input checked="" type="checkbox"/>	Dispatch slot technician or Gaming Commission to machine to test coin-in meters accompanied by auditing personnel.
4		Contacted _____ in surveillance department and requested that surveillance review surveillance logs for possible suspicious activity.
5		Review historical meter to drop variance report and look for unusual unresolved variances.
6		Test EPROM and/or seal on circuit boards.
7		Contact slot manufacturer to inquire about any known problems with machine.
8		Review records required to be maintained by 542(h)(7).
9		Review jackpot tickets for month unusual variance was noted, for unusual activity including any excessive number of manual jackpot overrides.
10		Make sure that machine is set internally to the correct denomination.
11		Review system exception reports for inappropriate access to machine(s).
12		Make sure that jackpots and TITO tickets issued are not being duplicated.
13		Other investigations:

Follow up (check all that apply):		
1	<input checked="" type="checkbox"/>	Examined theoretical hold % from manufacturer. No exceptions noted.
2	<input checked="" type="checkbox"/>	Exception noted on bad meter report. Coin in meter did not change through last 2 drop cycles. Problem with slot circuitry noted. Adjustment required.
3	<input checked="" type="checkbox"/>	Coin-in meter is not functioning properly based upon test performed on April 3, 2007 by J SlotTech and N Auditor.
4		Nothing unusual noted by surveillance department.
5		No unusual variances noted.
6		No exception noted from examination of seal.
7		Nothing noted based upon inquiries of slot manufacturer.
8		Records appeared to be complete. No changes have been made to machine since being placed on floor.
9		No manual jackpots identified.
10		Examined machine. No exceptions noted with denomination.
11		No inappropriate access noted based upon review of March 2007 exception reports.
12		Traced total jackpots plus tickets issued per system report to Net win report for 3 days. No exception noted.
13		Document results of other investigations.

Documentation (check all that apply):		
1	<input checked="" type="checkbox"/>	Retain copy of manufacturer's par sheet.
2	<input checked="" type="checkbox"/>	Retain copy of bad meter report.
3	<input checked="" type="checkbox"/>	Retain copies of coin-in meter testing performed.
4		Retain copies of correspondence with surveillance department.
5		Retain copy of drop to meter variances if unusual variances noted.
6		Document nature of exception if noted from testing of EPROM or examination of seal.
7		Retain copies of correspondence with slot manufacturer or document telephone calls.
8		Retain copies of any records that show any exceptions.
9		Retain reference #s of any significant jackpot overrides.
10		Retain print screens or other documentation if exceptions noted.
11		Retain exception reports if inappropriate access to machines noted.
12		Retain documentation of testing performed on 3 test dates.
13		Retain other documentation for other investigations.

Note: If reports can be rerun from slot system there is no need to retain physical copies

Other comments:	

Conclusion:	
	Based upon investigation into variances, it was noted that the coin-in meter was not functioning properly. Machine was repaired and meters were subsequently functioning properly. Based upon review of updated statistical reports, the variance between actual and theoretical was less than 3%.

Signed: _____

Dated: _____

5. Most internal audit groups now include overall ratings or conclusions in audit reports

Most internal audit departments—including 85% of our Fortune 1000 respondents—now include overall ratings or conclusions in their audit reports. In our 2006 survey, 79% of the 377 organizations addressing this subject routinely include an overall rating or conclusion to reflect audit results.

Such ratings are strongly applauded by audit committees, which tell us they appreciate receiving knowledgeable, easy-to-grasp insights from internal audit about significant risk-management issues facing the organizations they oversee. At the same time, there is little consistency in either the basis for issuing such ratings today or in the approaches taken to developing such ratings, although the ratings process itself is now generally considered by many to be a best practice.

The increasing prevalence of audit ratings is being driven by a number of factors, including an increased focus on internal audit reports by audit committees, senior management, and external auditors; the desire by chief audit executives to synthesize the assessment of risks and controls; and pressure from regulators in certain heavily regulated industries.

With audit ratings, internal audit can determine the extent to which failure to identify risks or implement recommended controls contributes to business units falling short of their objectives. Audit report ratings also can serve as the basis for follow-up attention from internal audit or the audit committee and, in rare instances, can serve as the basis for adverse actions against members of operating or executive management.

Although the formats of audit ratings reports will vary, they are all constructed to convey a basic continuum of performance. A common approach is to rate the overall performance of the function, program, or activity subject to audit adjectivally: *strong, effective, adequate, requires attention, or weak*. Another approach might feature a “heat map” that assigns color designations derived from the number of action items stemming from an audit. For example, internal audit might assign:

- Red to an audit indicating weak controls and requiring multiple “red action items”
- Orange to an audit indicating the need for a moderate level of controls and requiring a business unit to address one or two “red action items”
- Yellow to an audit indicating the need for moderate controls and no “red action items,” but one or two less serious “yellow action items”
- Green to an audit indicating the presence of strong controls, where a business unit is consistently managing risks to an acceptable level

As one would expect, there are definite perceived advantages as well as disadvantages to including ratings with audit reports. On the plus side, audit ratings permit more rapid assessment of overall results by senior management and audit committees. They also help facilitate the design and implementation of monitoring systems by internal audit and various governance bodies. And, they can serve as a motivational tool to spur business units to strive for the top ratings possible.

On the downside, audit report ratings can undermine good auditor/client relationships by creating friction between internal audit and operating units. In such cases, operating unit managers may be reticent to share known control weaknesses with members of an audit team. Another disadvantage is the potential of audit ratings to increase audit cycle time by extending the reporting process.