

STATE OF MINNESOTA
DEPARTMENT OF REVENUE

In The Matter Of The Proposed
Rules Of The Department Of Revenue
Relating to Lawful Gambling Annual Audits
And Reviews

STATEMENT OF NEED
AND REASONABLENESS

I. INTRODUCTION AND BACKGROUND

This rulemaking proceeding proposes to adopt a permanent rule relating to Lawful Gambling Annual Audits and Financial Reviews of Licensed Organizations. It is submitted pursuant to Minnesota Statutes, sections 14.23 (1994), 297E.06, subd. 4 (1994), and Minnesota Rules, Part 1400.0500 (1993) requiring a Statement of Need and Reasonableness.

A Notice of Intention to Solicit Outside Information or Opinions Regarding Proposed Rules Governing Lawful Gambling-Annual Audit and Financial Reviews of Licensed Organizations was published in the *State Register* on July 18, 1994. The notice specifically mentioned this rule and invited interested persons to submit comments or suggestions in writing or orally to the Department of Revenue. The rule was published in the *State Register* on August 14, 1995 and is being mailed to all persons on the Department of Revenue's mailing list who have expressed an interest in the rulemaking activities of the department.

II. PUBLIC ADVISORY COMMITTEE

The Minnesota Department of Revenue formed a Public Advisory Task Force consisting of representatives from the Minnesota State Board of Accountancy, accounting firms, Licensed Charitable Organizations, the Department of Public Safety-Gambling

Enforcement Division, and the Lawful Gambling Control Board. The Task Force met on several occasions and consisted of the following members:

Steve Peterson - Department of Public Safety
Dave Erickson - Department of Public Safety
Mary Monson, LPA - MN State Board of Accountancy
Robin Johnson - Representing Allied Charities
Bob Matson - Representing Allied Charities
Marie Robinson - Gambling Control Board
Lee Graczyk-Gambling Control Board
Chris Mau-Gambling Control Board
Steve Bodine, CPA - Larson, Allen, Weishair & Co.
Richard Cornell, CPA - Schreier, Kosbab, Cornell, Kahler & Co.
Jack Abdo, CPA - Abdo, Abdo & Eick
Steven Baker, LPA-Accountax
Mike Sands, CPA - Kumment, Larson, Bluth & Co.

Revenue Department employees participating in the Public Advisory Task Force meetings included Roger Swanson, Patrick Finnegan, Joe Nelson, Pam Petroska, and Amy Kondrasuk.

III. IMPACT ON SMALL BUSINESS

Minnesota Statutes, section 14.115 requires an agency, when proposing a new rule or amending an existing rule that may affect small businesses, to consider certain methods of reducing the impact of the rule on small businesses. The impact of this rule on small businesses has been considered. The proposed rule does not impose new filing or payment requirements on small businesses and, therefore, is not expected to place any additional financial or administrative burden on small businesses. The rule is meant to prescribe the standards for the annual audits and reviews required by Minnesota Statutes, section 297E.06, subdivision 4. A Public Advisory Task Force was formed including

representatives of organizations required to have these annual audits and reviews. The Task Force discussed the impact of the rule on small businesses and concluded that the rule would create a more level playing field among small and large organizations by setting forth uniform audit and review standards.

IV. COSTS TO LOCAL PUBLIC BODIES AND AGRICULTURAL LAND

IMPACT

Pursuant to Minnesota Statutes section 14.11, the proposed rule will not require the expenditure of public monies by local units of government and will not have any direct adverse effects on agricultural lands in the state.

V. DEPARTMENTAL CHARGES IMPOSED BY THE RULES

Minnesota Statutes, section 16A.128, subdivision 1 does not apply inasmuch as the rules do not set fees or departmental charges.

VI. FISCAL IMPACT

A fiscal note is not required pursuant to section 3.892 as the rule will not force any local agency or school district to incur costs.

VII. AUTHORITY TO ADOPT RULES

Minnesota Statutes, section 270.06 (1994) grants the Commissioner of Revenue authority to promulgate rules concerning administration and enforcement of the gambling tax laws.

VIII. WITNESSES

If these rules go to a public hearing, the witnesses listed below may testify on behalf of the Department of Revenue in support of the need for and reasonableness of the

rules. The witnesses will be available to answer questions about the development and content of the rules.

Roger Swanson, State of Minnesota, Department of Revenue

Joe Nelson, State of Minnesota, Department of Revenue

Amy Kondrasuk, State of Minnesota, Department of Revenue

The Department of Revenue will be represented by Patrick J. Finnegan, Attorney at Law, Legal Services Unit, Minnesota Department of Revenue.

IX. DETAIL OF THE PROPOSED RULE

8122.0100 Scope; Purpose.

This is a general introductory section which cites the statutory mandate under Minnesota Statutes, section 297E.06 subd. 4 for certain organizations licensed under Chapter 349 to have annual audits or reviews performed by independent accountants licensed by the state of Minnesota. The statute directs the Commissioner of Revenue to prescribe the standards for annual audits and reviews. It is reasonable and necessary to include the statutory reference because the standards set forth in the rule are based upon the statutory requirements.

8122.0150 Definitions.

Subpart 1. Clarifies that the “scope” of the definitions for the rule are those set forth in the Lawful Gambling Tax Chapter in Minnesota Statutes Chapter 297E unless defined separately under the rule. It is reasonable and necessary to explain how terms under the rule are defined.

Subpart 2. The term “accrual basis” is defined here. It is necessary to define this term since it is used in the determination of regulatory basis of accounting. The definition is reasonable since it is commonly understood and practiced in the industry.

Subpart 3. The term “audit” is defined here. It is necessary to define this term since there are different filing requirements for organizations with gross receipts under \$250,000 and over \$250,000. It is reasonable because the definition is based on the definition of an attest engagement as defined in the AICPA Codification of Statements on Auditing Standards AT Section 100.01.

Subpart 4. The term “CPA” is defined here. It is necessary to define this term as it is used in Minnesota Statute, section 297E.06. The definition is reasonable because it is a reproduction of the definition as found in Minnesota Rules, part 1100.0100, subp. 2 and part 1100.0100, subp.3.

Subpart 5. The term “cash basis” is defined here. It is necessary to define this term since it is used in the determination of regulatory basis of accounting. The definition is reasonable since it is commonly understood and practiced in the industry.

Subpart 6. The term “ending inventory” is defined here. It is necessary to define this term as it is used in the presentation of financial statements and required monthly tax filings. The definition is reasonable because this definition is commonly understood and practiced in the industry.

Subpart 7. The term “LPA” is defined here. It is necessary to define this term as it is used in Minnesota Statute, section 297E.06. The definition is reasonable because it is a

reproduction of the definition as found in Minnesota Rules, part 1100.0100, subp. 6 and part 1100.3800, subp. 10.

Subpart 8. The term “material weakness” is defined here. It is necessary to define this term as it is used in relating to the internal control structure of an organization. The definition is reasonable because it is a reproduction of the definition as found in AICPA Professional Standards (AU 325).

Subpart 9. The term “regulatory basis” is defined here. It is necessary to define this term as it is the required accounting basis for the annual audits and reviews and monthly tax filings. The definition is reasonable because this definition is commonly understood and practiced in the industry.

Subpart 10. The term “reportable condition” is defined here. It is necessary to define this term as it is used in relating to the internal control structure of an organization. The definition is reasonable because it is a reproduction of the definition as found in AICPA Professional Standards (AU 325).

Subpart 11. The term “review” is defined here. It is necessary to define this term since there are different filing requirements for organizations with gross receipts under \$250,000 and over \$250,000. It is reasonable because the definition is based on the definition as defined in the AICPA Codification of Statements on Auditing Standards.

Subpart 12. The term “year” is defined here. It is necessary to define this term as it is used in determining the organization’s fiscal year end to be audited. The definition is reasonable because it is commonly understood and practiced in the industry.

8122.0200 Accountants Qualifications.

Subpart 1. License Required. This part is necessary because accountants performing audits and reviews must meet certain requirements established by the Minnesota State Board of Accountancy and the Minnesota Department of Revenue. The qualifications are reasonable because they are within the interpretations of the AICPA Professional Standards, and AICPA Codification of Statements on Auditing Standards (AU Section 110.03, AU Section 220) and Minnesota Statute, section 326.19 and Minnesota Rules, part 1100.4400.

Subpart 2. Standards of Independence. This part is necessary because it helps set forth the criteria for accountants and the organizations that hire them, to understand when an accountant or accounting firm is disqualified from performing the audit or review due to lack of independence from the organization's records. These standards are modeled upon the AICPA Professional Standards.

8122.0250 Due Date; Extensions.

This part is necessary because it establishes the due date and authority for granting extensions for the annual audits and reviews. The due dates are reasonable because it does not place undue burden upon organizations to complete the annual audit or review requirements within these time frames.

8122.0300 Communication Of Illegal Acts, Material Errors, and Irregularities.

This part is necessary and reasonable to assist the Department of Revenue's limited staff in obtaining information regarding illegal acts which affects the integrity of the gambling industry.

8122.0350 Accounting Records.

This part is necessary and reasonable because organizations are required to maintain minimum accounting records as stated in Minnesota Statute Chapters 349 and 297E and Minnesota Rule, part 7861.

8122.0400 Accountant's Workpapers.

This part is necessary and reasonable because auditing standards require that workpapers support the accountant's findings and must be maintained by the accountant for a reasonable period of time. The workpapers will provide information to the Department regarding the tests performed, procedures applied and conclusions reached by the auditors.

8122.0450 Termination Of Audit Engagement Or Review.

This part is necessary since organizations are required by statute to have an annual audit or financial review. It is reasonable because withdrawal from an engagement may be an indication of problems and the inability of the organization to meet filing requirements.

8122.0500 Less Than A 12 Month Audit Or Review.

This part is necessary and reasonable to further clarify the filing requirements for an organization who conducts gambling for less than 12 months during the organization's fiscal year and to further clarify the period to be audited when an organization terminates gambling activity during the fiscal year based on if a termination plan has been filed and approved, filed and awaiting approval, or not filed.

8122.0550 Audit.

Subpart 1. Minimum requirements. This part is necessary to establish the statements, schedules, notes and reports to be included as part of the annual audit. It is reasonable because the statements are required as part of the basic financial statements. The schedules and reports required are reasonable because they are used in connection with statutory and regulatory requirements.

Subpart 2. Opinion. This subpart is necessary and reasonable because it provides assurance that the financial statements presented are present fairly in accordance with Generally Accepted Auditing Standards.

Subpart 3. Financial Statements. Items A through D are necessary and reasonable because they are part of the basic financial statements of an audit as discussed in AICPA Codification of Statements on Auditing Standards AU Section 623.02.

Subpart 4. Supplemental schedules. Items A through C are necessary to assist limited staff in determining compliance with certain statutory and regulatory items. It is reasonable because the statutes and regulations dictate these records be maintained.

Subpart 5. Sampling and Testing; Closed Games. Items A through C are necessary to establish guidelines for auditors in selecting the number of closed games to be tested which is a costly part of the audit. Criteria are also set forth for sampling and the types of games that need to be sampled. Previously, no guidelines were issued resulting in a disproportionate number of games being tested as compared to gross receipts. This guideline is reasonable because it will assist organizations in comparing the costs of bids to perform their annual audit. The number of games to sample was determined after surveying accounting firms and after much discussion with the task force advisory group.

Subpart 6. Report on Internal Control Structure and Other Matters. Items A and B are necessary to assist organizations in strengthening their internal controls and providing the Department of Revenue with a general view of the organization's internal controls and compliance with regard to laws and rules. It is reasonable because the report is a by-product of the audit and follows the requirements established under the most recent edition of the internal audit standards as provided by audit section 325.11 of the American Institute of Public Accountants-"The Standards of Field Work-Communication of Internal Control Structure Related Matters Noted in an Audit", last published June 1, 1994.

Subpart. 7. Organization's Response to Report on Internal Control Structure. Items A through C are necessary to force organizations to address weaknesses in internal control or compliance areas of their gambling operations. It is reasonable because gambling is highly scrutinized and organizations are held accountable for maintaining good controls and compliance with laws and rules.

Subpart 8. Other. Items A and B require the organization's license number and Minnesota state ID number be included on the front of the audit. It is reasonable and necessary to facilitate the filing of the audit or review with the Department of Revenue.

8122.0600 Review.

Subpart 1. Minimum Requirements. This part is necessary to establish the statements and schedules to be included as part of the annual financial review. It is reasonable because the statements are required as part of the basic financial statements. The

schedules required are reasonable because they are used in connection with statutory and regulatory requirements.

Subpart 2. Limited Assurance. This subpart is necessary and reasonable because it provides limited assurance that the financial statements presented contain no material modifications that should be made to the statements for them to be in conformity with the regulatory basis of accounting.

Subpart 3. Financial Statements. Items A through D are necessary and reasonable because they are part of the basic financial statements as discussed in AICPA Codification of Statements on Auditing Standards.

Subpart 4. Supplemental Schedules. Items A through C are necessary to assist limited staff in determining compliance with certain statutory and regulatory items. It is reasonable because the statutes and regulations dictate these records be maintained.

Subpart 5. Other. This subpart requires the organization's license number and Minnesota state ID number be included on the front of the financial review. It is reasonable and necessary to facilitate the filing of the audit or review with the Department of Revenue.

8122.0650 Failure To File Or Failure To Meet Requirements.

Subpart 1. Failure to File. This part is necessary and reasonable to state the repercussions of not filing the annual audit or annual financial reviews as required under Minnesota Statute, section 297E.

Subpart 2. Failure to Meet Requirements. This part is necessary and reasonable to state the repercussions if the annual audit or annual financial reviews do not comply with all or part of the statutory or rule requirements.

X. CONCLUSION

Based on the foregoing, the proposed Minnesota Rules, parts 8122.0100 through 8122.0650 are both necessary and reasonable.