

## **Emerging Issues in the Use of Free Play**

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### Emerging Issues in the Use of Free Play

Non-negotiable slot credits, or what is commonly called free play has become the primary form of customer incentives in many casinos around the globe and has essentially replaced cash in those jurisdictions that permit it. Free play is now used instead of cash for point redemptions, mail coupons and a variety of promotions including bounce back offers, hot seat awards and celebration jackpots. Combined, these various forms of free play have become the single greatest component of player reinvestment. The increased use of free play has also created unintended consequences that were not anticipated at its inception. Free play has affected multiple departments within the casino including Slots, Marketing, Accounting and Finance. For many casinos, the unanticipated impact of free play is only now being felt. This article attempts to identify the emerging issues of free play and how they are impacting customer satisfaction and casino profitability.

#### Accounting for free play

One of the primary issues regarding free play is how to account for it on the income statement and what costs should appear. There is a dramatic range of opinions on how free play should be accounted for and how its effects should be measured. Does a dollar in free play cost a dollar? Is it free or is its cost somewhere in between? Views differ depending if you are a regulator, accounting manager, marketing executive or senior executive.

There are those who would argue that free play is simply a marketing tool that allows a customer to initiate a handle pull and any winnings generated by that handle pull will eventually be cycled back into the machine. To them there is no real cost to the casino except perhaps, in a modest reduction of slot hold, which can be periodically increased to compensate for that loss. The “free play is free” contingent believes that, unlike cash, free play should not show up as a marketing expense on the income statement and can simply be tracked in a contra revenue account. Casino marketers in particular like this approach since it allows them to dramatically increase their marketing expense without requiring an increase in their marketing budgets.

Others would argue that free play should be booked as cash, less the aggregate hold of the slot floor. For example, if a customer receives \$100 in free play and the slot floor hold is 8%, then \$92 should be booked as an expense. Still others believe that, since free play can be cycled through the machine only once and any winnings generated from that cycle can be redeemed for cash, free play should be booked at 100% of its value, just as if it were cash.

In many jurisdictions, free play redemptions are treated just like cash coupons in which the state or governing body taxes free play at the same tax rate as gaming revenue. Until 2009, the West Virginia Lottery viewed free play issued by a racino to be the same as a cash coupon. Any coupons that were redeemed and played into a slot machine were taxed at an effective tax rate of 57% as if it were net machine revenue. This essentially made West Virginia’s three racinos the state lottery’s best customers. Pennsylvania on the other hand, allowed its casinos to deduct free play as a promotional expense from net machine revenue before gaming taxes were applied. This put West Virginia’s casinos at a severe disadvantage to its competitors. In 2009 the West

Virginia Lottery altered its regulations and allowed its three racinos to issue free play without tax implications with the hope that it would allow the racinos to generate more gaming revenue for the state and make the casinos more competitive.

Other jurisdictions continue to treat free play as if it were cash or prohibit its introduction. Both Colorado and South Dakota do not permit the issuance of free play. Casinos in those markets must issue cash coupons, which when played are taxed as gaming revenue. Casinos then book those cash redemptions as an expense on their income statements. Again, the sole beneficiaries of such regulations are the state governments. This policy also affects Indian casinos in those jurisdictions where a percentage of gaming revenue is shared with the state. Even though Indian casinos issue promotional free play offers, redemptions are still viewed by the state as gaming revenue, from which a share must be paid.

While there is no clear and consistent policies regarding free play on the income statement, failure to the very least note it (as revenue and offsetting expense) on the income statement creates a situation where management loses sight of the amount of free play issued. Contra revenue accounts alone cannot accomplish this. Marketing, Slots, Accounting and Finance all need to know how much free play the casino is issuing and both the daily operating report and monthly income statement are appropriate vehicles for that purpose.

Until the industry adopts standard accounting practices for free play, each casino company is left to decide how best to show this expense or whether to show it all.

#### Cash protection and free play protection

It can be argued, quite forcefully, that free play is much like cash. A patron can redeem a free play offer, wager that free play once and cash out whatever drops to the slot machine's win meter. In this case, free play is pretty much like cash and therefore it needs to be protected, just like cash.

Casino operators are very good at protecting cash and long ago developed controls to protect its most liquid asset. Cash is kept in a vault. The vault is usually surrounded by a cashier's cage. The cage is normally in clear view of a security officer seated in an elevated podium. A plethora of alarms and other security devices protect that cash and cameras monitor the movement of cash within the vault, the cage and at the cashier's cage window.

Casinos have long had in place methodologies to distribute cash and to properly account for those dispersals. Take for instance the redemption of slot club points for cash back. First a customer would go to the players' club booth and present their identification and players' club card. The players' club representative would verify the customer's identity; look up the customer's account and issue a redemption through the casino management system. A coupon, often called script, would then be printed on check-like paper (in triplicate) with a unique identifying number in red ink. Often a supervisor would be required to initial the script before giving it to the customer. The customer would then go to the cashier's cage, where once again identification would be requested. The cashier would verify the amount, verify the redemption on a computer terminal and then give the customer their cash. A security camera would record the transaction. The coupon would then be sent to revenue audit where the transaction would be

reconciled. The total amount of cash issued for points would appear on the next day's daily operating report and on the monthly income statement as an expense, charged to either the slot department or players club.

Point redemptions for free play are, for the most part, electronic. A customer can simply sit down at a machine, insert their players' club card in a reader box, enter their personal identification number, and convert bonus points to free play. Some casinos, because of system limitations, make a customer stop by the rewards center to verify the account before issuing free play. The former is far more convenient for both the customer and casino operator and requires far less labor. There of course is an audit trail and the total amount of points redeemed may be accounted for in a contra revenue account or some other internal audit process. However, since it is no longer a cash expense, points redeemed for free play does have to appear on the daily operating report or the inc

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