

Financial Reporting Center – Revenue Recognition

Working Draft: Gaming Revenue Recognition Implementation Issue



Issue # 6-6: Income Statement Presentation of Wide Area Progressive Operators' Fees Received from Gaming Entities

Expected Overall Level of Impact to Industry Accounting:
Significant

Wording to be Included in the Revenue Recognition Guide:

Background

1. Gaming entities periodically enter into participation arrangements with gaming suppliers. In participation arrangements, the title to the slot machine is typically retained by an owner/seller, such as the manufacturer of a machine. The agreements between the gaming entity and the owner/seller stipulate that the entity and the owner/seller share participate in the gaming activity by sharing either the win or by the gaming entity paying a fixed percentage of coin in or a flat fee to the owner/seller.
2. Operators provide a wide area progressive (WAP) Offering to Gaming Entities. The Operator enters into a contract with the Gaming Entity to provide the Gaming Entity with WAP gaming machines which are connected to a WAP system. The WAP system links all WAP gaming machines located throughout a jurisdiction within various gaming entities that are unrelated to the WAP operator.
3. As Patrons play the WAP gaming machines located across the multiple gaming entities, a percentage of their play contributes to the system-wide WAP Jackpot award. The system-wide WAP Jackpot continues to increase through Patron play until the point at which a Patron hits (wins) the WAP Jackpot. Hundreds or thousands of Patrons (this is a conservative estimate) play a WAP system before one Patron hits the WAP Jackpot. Once the WAP Jackpot hits, it resets and the cycle begins again.
4. The WAP Offering typically increases gaming machine play by giving Patrons the opportunity to win a significantly larger jackpot than on non-linked gaming machines.
5. From the perspective of a gaming entity, WAP arrangements function in a manner similar to participation arrangements but are not participation arrangements. In WAP arrangements, the fees paid by the gaming entity

to the WAP Operator primarily relate to the services provided to maintain and operate a wide area progressive system, including the WAP Jackpot.

Analysis of Lease Criteria for Various Arrangements

6. The primary accounting guidance relating to participation and similar arrangements is described in FASB ASC Topic 840, *Leases*.
7. To determine whether the arrangement is accounted for as a lease under FASB ASC Topic 840, an analysis of the specific terms of each contract governing a participation, third party license, or WAP arrangement is typically performed by each party to the arrangement using the guidance explained in FASB ASC 840-10-15.

Gaming Entity – Fees to WAP Operator

8. For WAP arrangements determined to not include a lease¹, FinREC believes that the Gaming Entity would report fees paid to the WAP Operator pursuant to a WAP arrangement as an expense consistent with payments for goods and services received from a vendor. For example, consider the following:

Assumptions:

Gross Amount Wagered by Patrons	\$ 100.00
Amount Paid Out by Gaming Entities to Patrons	\$ (87.00)
Win From Patrons	<u>\$ 13.00</u>
Operator's Share of Gross Amount Wagered (per contract)	6.00%
Operator's Contribution to WAP Jackpot	2.00%

Income Statement Impact:

Revenue	\$ 13.00
Contra Revenue	<u>-</u>
Gaming Revenue, net	<u>\$ 13.00</u>
Gaming Expense	<u>6.00</u>
Operating Income	<u>\$ 7.00</u>

WAP Operator – Fees from Gaming Entity

9. For WAP arrangements determined to not include a lease², the guidance in FASB ASC Topic 606 should be applied. The following provides an analysis of such arrangements under FASB ASC Topic 606.

The five steps of the revenue recognition model under FASB ASC 606 are assessed as follows:

Step 1: Identify the Contract with a Customer

10. FASB ASC 606-10-25-1 provides criteria that must be met in order to have a contract with a customer under the guidance in FASB ASC Topic 606. FASB ASC 606-10-25-2 notes that, “a contract is an agreement between two or more parties that creates enforceable rights and obligations.” The FASB ASC Glossary defines customer as “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.” Further, FASB ASC 606-10-32-25 indicates that a customer includes other parties that purchase the entity’s goods or services from the customer, which is the Gaming Entity for purposes of a WAP arrangement.
11. In assessing the applicability of FASB ASC 606, the WAP Operator will typically have a written agreement with the Gaming Entity that includes explicit requirement for the WAP Operator to pay the WAP Jackpot directly to the winning WAP Jackpot Patron.

Step 2: Identify the Performance Obligations in the Contract

¹ In situations where the WAP arrangement is determined to be a lease the Gaming Entity would follow the guidance in FASB ASC Topic 840 which generally requires fees paid under the arrangement to be classified as expenses in the income statement when the arrangement is considered an operating lease.

² If a wide area progressive arrangement is determined to contain a lease, the entity would need to separate the non-lease components of the arrangement from the lease components and account for the non-lease components in accordance with FASB ASC Topic 606 and the lease components in accordance with FASB ASC Topic 840 for lessors.

12. Typically the WAP Operator provides an offering to Gaming Entities that requires the WAP Operator to provide the Gaming Entity with WAP gaming machines which are connected to a WAP system. The WAP system links all WAP gaming machines located within various unrelated gaming entities throughout a jurisdiction. Because these WAP gaming machines are linked, the payout amounts that can be won by the Patron are increased significantly. The WAP Operator also manages all monies received for funding WAP Jackpot awards and is contractually responsible for funding and paying the WAP Jackpot awards to the Patrons who win the WAP Jackpots.
13. A WAP Operator should assess the different potential performance obligations in the WAP arrangement which would result in the following potential performance obligations:
 - a. Provide and setup functioning WAP gaming machines and related WAP meters and signage, connected to the WAP system;
 - b. Provide the WAP Offering inclusive of related services such as monitoring the WAP system, maintaining the functioning of the WAP system and other services ensuring proper functioning of the system with the WAP gaming machines, and the obligation, either by regulation and agreement with the Gaming Entity, to pay the WAP Jackpot awards to the Patrons who win the WAP Jackpots.
14. The WAP Operator does not provide Gaming Entities with WAP gaming machines independent of the WAP Offering and vice versa. A Gaming Entity enters into an arrangement for the WAP gaming machines and the WAP Offering, which includes the requirement by the WAP Operator to pay the WAP Jackpot, on a combined basis. Accordingly, a WAP Operator should assess whether the potential performance obligations are distinct and therefore separate performance obligations under FASB ASC 606.
15. FASB ASC 606-10-25-19 indicates that a good or service... is distinct if both of the following criteria are met:
 - a. The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct).
 - b. The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (that is, the good or service is distinct within the context of the contract).
16. FinREC believes that the WAP gaming machines and the WAP Offering do not meet the criteria in FASB ASC 606-10-25-19(b), and would not be distinct within the context of the contract, as the WAP gaming machines and the WAP Offering are highly interdependent and interrelated. Therefore, FinREC believes there is one distinct performance obligation within the arrangement.

Series of Distinct Goods or Services

17. As discussed in FASB ASC 606-10-25-14, a performance obligation is either a good or service that is distinct or a series of distinct services that are substantially the same and have the same pattern of transfer to the customer as described in FASB ASC 606-10-25-15.
18. Paragraph 14 of FASB / IASB TRG Agenda Ref. 39, *Application of the Series Provision and Allocation of Variable Consideration*, discusses Topic 1: *In order to apply the series provision, how should entities consider whether the performance obligation consists of distinct goods or services that are substantially the same?*, states that "in order to be considered a series, there must be more than one good or service that is distinct and each distinct good or service must also be substantially the same."
19. FinREC believes the promise to stand ready to provide the WAP Offering each day, represents a series of distinct services which is the WAP Operator's promise to provide daily access to the WAP Offering over a period of time, and not a specified amount of services or access³. While the underlying activities associated with the WAP Offering will vary both within a day and day to day, FinREC believes that the WAP Offering is accessed over time and that the customer simultaneously receives and consumes the benefit from the WAP Operator's performance of providing WAP access (including other related activities). Each day of access to the WAP Offering is distinct and has substantially the same pattern of transfer to the customer⁴ and therefore should be accounted for as a single performance obligation in accordance with paragraphs 14 -15 of FASB ASC 606-10-25.
20. FinREC believes that the promise to stand ready to provide daily access to the WAP Offering is a series of distinct services that represents a single performance obligation when:

³ The WAP Offering is similar to obligations as described in TRG Issue Paper #16, "Stand-Ready Performance Obligations".

⁴ As described in FASB ASC 606-10-25-27 and FASB ASC 606-10-25-31.

- a. The WAP Operator concludes that the promise to provide daily access to the WAP Offering is a performance obligation satisfied over time because the gaming entity simultaneously receives and consumes the benefits provided as the service is performed. Therefore, FinREC believes the WAP Offering meets the criterion of FASB ASC 606-10-25-15(a).
- b. The same measure of progress (a daily time based increment) would be used to measure the WAP Operator's progress toward complete satisfaction of the performance obligation to provide the daily right to access the WAP Offering. Therefore, FinREC believes the WAP Offering meets the criterion of FASB ASC 606-10-25-15(b).

Step 3 - Determine the Transaction Price

21. The transaction price should be determined in accordance with the guidance in paragraphs 2 – 27 of FASB ASC 606-10-32.
22. The WAP Operator receives fees from the Gaming Entity for providing the WAP Offering based upon the amount of coin-in from the Patrons. The WAP Operator determines the amount of fees received from the Gaming Entity that will be allocated to the WAP Jackpot. When that WAP Jackpot is won by a Patron, the WAP Operator is responsible for such payment.
23. FASB ASC 606-10-32-3 explains that when determining the transaction price of a contract with a customer an entity should consider the effects of consideration payable to a customer.
24. FASB ASC Topic 606 requires that an entity account for consideration payable to a customer as a reduction of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. Specifically, FASB ASC 606-10-32-25 states,

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity. An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. ...
25. FinREC believes that the WAP Operator's costs incurred for WAP Jackpot awards to the Patron would be accounted for as consideration payable to the customer, since the payment made to a customer's customer (the Gaming Entity's customer) is part of the WAP Operator's contractual agreement with the Gaming Entity. FinREC believes that the payment from the WAP Operator to the Patron is not in exchange for a distinct good or service that the Patron transfers to the Operator.
26. FinREC believes that the transaction price ultimately recognized as revenue by the Operator generally includes fees earned from Gaming Entities reduced by costs incurred for WAP Jackpot awards. For example, consider the following:

Assumptions:

Gross Amount Wagered by Patrons	\$ 100.00
Amount Paid Out by Gaming Entities to Patrons	<u>\$ (87.00)</u>
Win From Patrons	<u>\$ 13.00</u>
Operator's Share of Gross Amount Wagered (per contract)	6.00%
Operator's Contribution to WAP Jackpot	2.00%

Income Statement Impact:

Revenue	\$ 6.00
Contra Revenue	<u>\$ (2.00)</u>
Total Revenue	<u>\$ 4.00</u>
Cost of Sales	<u>\$ -</u>
Gross Margin	<u>\$ 4.00</u>

Step 4 - Allocate the Transaction Price to the Performance Obligations in the Contract

27. FASB ASC 606-10-32-29 indicates that an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis in accordance with paragraphs 606-

10- 32-31 through 32-35, except as specified in paragraphs 606-10-32-36 through 32-38 (for allocating discounts) and paragraphs 606-10-32-39 through 32-41 (for allocating consideration that includes variable amounts).

Allocation of the Variable Fees within the Agreement to the Separate Performance Obligations and/or to the Distinct Good(s) or Services that Form Part of a Single Performance Obligation

28. As noted in FASB ASC 606-10-32-40, a WAP Operator should allocate variable fees entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation if both of the following criteria are met:
- a. The terms of the variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and
 - b. The allocation of the variable amount to the performance obligation or the distinct good or services is consistent with the allocation objective when considering all the performance obligations and payment terms in the contract.
29. If the WAP Operator has concluded the performance obligation is a series of daily services for which the uncertainty regarding the consideration is resolved on a daily basis, FinREC believes the allocation of the monthly variable Royalty and System Assessment Fees to the daily services provided during the month they are billable would meet the allocation objective in FASB ASC 606-10-32-28 for each month.

Step 5 - Recognize Revenue When (or As) the Entity Satisfies a Performance Obligation

30. In addition, as noted in FASB ASC 606-10-55-18, as a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date, the entity may recognize revenue in the amount to which the entity has a right to invoice. As a result, the WAP Operator will recognize revenues as and when the underlying sales (i.e., gross gaming revenues) occur. This issue was also addressed in FASB/IASB TRG Agenda Ref 39: Application of the Series Provision and Allocation of Variable Consideration.
31. FinREC believes that a WAP Operator should recognize the amount of the transaction price allocated to the distinct daily service each day as the service is performed.

Comments should be received by August 1, 2017, and sent by electronic mail to Kim Kushmerick at kim.kushmerick@aicpa-cima.com, or you can send them by mail to Kim Kushmerick, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.