

## Financial Reporting Center – Revenue Recognition

# Working Draft: Gaming Revenue Recognition Implementation Issue



### Issue #6-7: Participation and Similar Arrangements

**Expected Overall Level of Impact to Industry Accounting:** Low

### 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. Gaming entities periodically enter into third party licensing arrangements with the owner/seller of a copyrighted game or other intellectual property. Title to the intangible asset (the copyrighted game or intellectual property) is typically retained by the owner/seller, who receives a flat fee per specified time period or percentage of coin in or net gaming win. Such arrangements may be day-to-day, month-to-month, or for periods exceeding 12 months.

#### *Analysis of Lease Criteria for Various Arrangements<sup>1</sup>*

3. The primary accounting guidance relating to participation and similar arrangements is described in FASB ASC Topic 840, *Leases*.
4. 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<sup>2</sup> is typically performed by each party to the arrangement using the guidance explained in FASB ASC 840-10-15.

<sup>1</sup> Accounting Standards Update No. 2016-02 was issued in February 2016 which supersedes existing guidance in FASB ASC Topic 840 and is generally effective beginning after December 15, 2018 for public entities. While the guidance for determining whether an arrangement is a lease generally has not changed, the general accounting for leases as operating and capital leases will change under the new standard for leases.

<sup>2</sup> WAP arrangements are discussed in Issue 6-06: Income Statement Presentation of Wide Area Progressive Operators' Fees Received from Gaming Entities

### *Conclusions and Income Statement Presentation*<sup>3</sup>

5. Participation arrangements are typically leases, as the arrangements will generally meet the criteria set forth in FASB ASC 840-10-15-6 and will therefore contain a lease because such arrangements allow a gaming entity to control a specified slot machine. Gaming entities usually report these arrangements as operating leases because none of the financing or capital lease criteria set forth in FASB ASC 840-10-25-1 have been met. The casino pays a percentage of the win of participating slot machines to slot machine lessors. Usually, the win is recorded as revenue within the income statement and the participating fees paid to slot machine lessors is recorded as an expense.
6. Third party license arrangements are typically not leases.
7. In accordance with the guidance in paragraphs 36 – 40 of FASB ASC 606-10-55, the gaming entity should evaluate whether they are acting as a principal or agent in providing the licensed games to its customers.
8. FASB ASC 606-10-55-36 states that “When another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods and services to be provided by the other party (that is, the entity is an agent).”
9. FASB ASC 606-10-55-36A states, “To determine the nature of its promise (as described in paragraph 606-10-55-36), the entity should:
  - a. Identify the specified goods or services to be provided to the customer...
  - b. Assess whether it controls (as described in paragraph 606-10-25-25) each specified good or service before that good or service is transferred to the customer.”
10. FASB ASC 606-10-55-39 contains a list of indicators that an entity controls the specified good or service before it is transferred to the customer, and is therefore a principal. The indicators in ASC 606-10-55-39 are not intended to be an exhaustive list.
11. While the fees paid pursuant to these arrangements are often characterized as “participation fees”, implying a potential principal versus agent arrangement, FinREC believes for a typical third party license arrangement related to a copyrighted game and its underlying intellectual property, the assessment of whether the gaming entity controls the revenue producing arrangement along with any analysis of the principal versus agent considerations in FASB ASC 606-10-55-38 through 606-10-55-40 indicates that the gaming entity is the principal in the arrangement and is simply contracting for the right to use the copyrighted game in its operations and the owner/seller does not control the service being offered. The gaming entity licensing the copyrighted game:
  - a. Has complete control and responsibility for determining if and when the specified regulatory approved game and related odds are provided in its casino to its customers under such agreement;
  - b. Is solely responsible and at risk for payouts to winning patrons – i.e. obligations arising from the outcome of wagers made by customers participating in the specified game. Conversely the owner/seller does not participate in the wager and is not at risk for payouts to winning patrons;
  - c. Has total discretion for “pricing” associated with the wagers (i.e. controls decisions over incentives and marketing offered to induce customers to wager on the game); and
  - d. Manages, operates, conducts and otherwise controls the operation of, location and results/outcome of the game (within the restraints dictated by the games rules and the regulator who has approved the use of such games in the gaming jurisdiction). Conversely the owner/seller has no such control or input into the operation of the game after it is licensed for use and has no ability to offer or conduct the game himself/herself without obtaining a gaming license to conduct gaming operations within the regulatory jurisdiction.

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<sup>3</sup> As noted in footnote 1 current lease accounting will be superseded beginning in 2018. Accordingly the specific guidance here around leases will change; however, such guidance will continue to preclude treatment of lease fees as a contra revenue.

12. FinREC believes all of these considerations listed in paragraph 11 are the responsibility of the gaming entity licensed to conduct gaming by a regulator. In accordance with FASB ASC 606-10-55-37B, fees paid pursuant to such arrangements would be reported as an expense rather than as a reduction to the revenue earned by the entity in its gaming operations.

Comments should be received by August 1, 2017, and sent by electronic mail to Kim Kushmerick at [kim.kushmerick@aicpa-cima.com](mailto: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.

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