

Financial Reporting Center – Revenue Recognition

Working Draft: Gaming Revenue Recognition Implementation Issue



Issue #6-8D: Accounting for Loyalty Points Redeemed with Third Parties

Expected Overall Level of Impact to Industry Accounting: Low

Wording to be Included in the Revenue Recognition Guide:

1. Gaming Issue #6-8A: *Accounting for Incentive Loyalty Programs Excluding Tier Status*, addresses the initial accounting for the earning of loyalty points. This issue addresses a narrow scope resultant issue and assumes that the gaming entity has a pre-existing performance obligation liability for outstanding loyalty points previously awarded.

Background

2. A casino customer is a member of that casino operator's customer loyalty program. The casino operator's customer loyalty program grants points to the customer based upon play that has been completed (usually contemporaneous with such play). Once earned, such points can be redeemed by the customer for a number of different types of incentives with both the gaming entity and third parties that participate in the gaming entity's "loyalty network".
3. Frequently gaming entities own shopping malls or food and beverage outlets attached to its casino and lease this space to retail operators who pay the gaming entity rent. To make the loyalty program more attractive to its customers and potentially draw more loyal members, gaming entities may enroll these retail operators in its loyalty network. Generally, under the terms of the loyalty program, loyalty program customers may redeem loyalty points with participating third parties in lieu of such customer paying those parties cash. In turn, the gaming entity then is required to make payments to the participating third party based on a formula in the arrangement in order to reimburse such participant for fulfilling the loyalty obligation on the casino's behalf.

Principal versus Agent

4. FASB ASC 606-10-55-36 states,

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 or services to be provided by the other party

(that is, the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 606-10-25-19 through 25-22). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

5. As stated in FASB ASC 606-10-55-37 “an entity is a principal if it controls the specified good or service before that good or service is transferred to the customer.”
6. FASB ASC 606-10-55-37B also states: “When (or as) an entity that is a principal satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred.”
7. FASB ASC 606-10-55-38 states,

An entity is an agent if the entity’s performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An entity’s fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

8. A sponsoring gaming entity (“Sponsor”) must assess whether it obtains control of the good or service being redeemed by its loyalty program member (“Member”) with a third party (“Network Partner”) before that good or service is transferred to the Member. If a Sponsor obtains control of the good or service in advance, it would record revenue and expense on a gross basis. The Sponsor would need to evaluate its third-party contracts under the principal versus agent considerations in paragraphs 36-40 in FASB ASC 606-10-55 in order to make a gross versus net determination.
9. FinREC believes that a Member’s redemption of loyalty points with a Network Partner under a typical loyalty program transaction described in paragraph 3 should generally be presented as a net activity in the Sponsor’s income statement, because the Sponsor generally does not control the specified good or service before that good or service is transferred to the Member in accordance with FASB ASC 606-10-55-38 as evidenced by the Network Partner having primary responsibility for fulfilling the good or service, including making any reparations if the good or service is found to be unacceptable. However, a Sponsor should assess its specific facts and circumstances in reaching its conclusion.
10. FASB ASC 606-10-55-36A provides that the assessment of principal versus agent criteria is based on an assessment of who controls “each specified good or service before that good or service is transferred to the customer.” This assessment cannot be made at the time the loyalty credit is issued, because the customer has not determined the “specified goods or services” to be delivered. The gaming entity evaluates whether it acts as an agent or principal in regard to the selected service or product when the selected service or product is known, which is at the time of redemption by the customer. This is further supported by the following views expressed in paragraph BC385 of ASU 2014-09,

In other cases, the points may entitle customers to choose between future goods or services provided by either the entity or another party. The Boards observed that in those cases, to determine when the performance obligation is satisfied, the entity would need to consider the nature of its performance obligation. This is because until the customer has chosen the goods or services to be provided (and thus whether the entity or the third party will provide those goods or services), the entity is obliged to stand ready to deliver goods or services. Thus, the entity may not satisfy its performance obligation until such time as it either delivers the goods or services or is no longer obliged to stand ready. The Boards also observed that if the customer subsequently chooses the goods or services from another party, the entity would need to consider whether it was acting as an agent and thus should recognize revenue for only a fee or commission that the entity received from providing the services to the customer and the third party.

11. When a Sponsor acts as an agent in regard to its Member’s loyalty redemptions with Network Partners, FinREC believes the Sponsor should recognize the net difference between the relieved liability associated with the loyalty points and the amount remitted to the Network Partner as other revenue from contracts with customers. The net amount would be recognized as other revenue from contracts with customers at the date when the performance

obligation is transferred to the Network Partner and the Sponsor is no longer obliged to stand ready to deliver goods or services (which would generally be the redemption date), consistent with the guidance in FASB ASC 606-10-55-40. See illustration of this in Example 1 - Entries to Record Redemption of Loyalty Points.

12. The following example is meant to be illustrative, and the actual determination of the appropriate accounting for the loyalty points under FASB ASC 606 should be based on the facts and circumstances of an entity's specific situation.

Example 1¹

Assume that a customer has 40,000 loyalty points as a result of past qualifying activity. Also, assume that the gaming entity sponsoring the loyalty program has previously determined that the value of each loyalty point is \$.01/point which has resulted in a liability being recorded for the above customer totaling \$400 as a result of a total of \$4,000 in combined gaming, hotel and food and beverage activity. For purposes of this example only, assume that the \$4,000 total transaction price yielded an allocation of \$400 to the loyalty points and \$3,600 to the associated revenue generating activity based on the relative selling prices of those performance obligations.

Note the following from paragraph 9 of Issue #6-8A: Loyalty Credits and Other Discretionary Incentives (Excluding Status Benefits):

Because of the nature of the transactions in the gaming industry, it is possible for a gaming entity to have no or even have negative revenue associated with transactions [with customers]. When loyalty credits are provided to a customer on such transactions, it is therefore possible that a negative transaction price could result from the loyalty programs. FASB ASC Topic 606 does not address the presentation of revenue in a contract resulting in a negative transaction price. FinREC believes that given the gaming industry's specific facts and circumstances (including the business model and the nature of the contracts entered into by gaming entities) it is appropriate for gaming entities to present this negative transaction price as a component of net revenue.

Also assume the following:

- a. Customer redeems all 40,000 loyalty points at a retail outlet enrolled in the Gaming Entity's loyalty network ("Retailer") for a leather day planner;
- b. Retailer determines the price of the day planner;
- c. Gaming Entity does not have any input into the operations of Retailer, except to the extent allowed or provided for in the customary lessor/lessee rental agreement, and has no responsibilities to the customer for product liability or customer satisfaction;
- d. Gaming Entity does not specifically track each individual point (i.e. it does not know which specific point has been redeemed, rather it pools points);
- e. Gaming Entity does not commit to a certain level of loyalty point redemptions at Retailer nor does it acquire any goods or services from Retailer; and
- f. Gaming Entity then remits \$300 to Retailer for fulfillment of points redeemed at Retailer. (Gaming Entity pays Retailer for fulfillment at \$0.0075 per point.)

Based on the facts above and consistent with paragraph 9, the gaming entity concludes it is an agent, as the gaming entity does not control the good or service from the third-party retailer before it is transferred to the customer upon redemption of the loyalty points. Therefore, in accordance with FASB ASC 606-10-55-38, the transaction with the third-party retailer should be presented on a net basis.

¹ For illustrative purposes this example assumes a redemption transaction with a single retailer at the terms specified. The gaming entity may have agreed with other retailers in the mall on different terms and conditions which would have to be considered for redemptions with such other retailers.

See the following journal entries:

Initial Entries to record the Point Liability

	<u>Dr.</u>	<u>Cr.</u>
Cash	\$ 4,000.00	
Gaming, hotel, food revenue		\$ 3,600.00
Loyalty program-performance liability		\$ 400.00

Gaming Entity records revenue for loyalty credit-earning activity based on fair value of each performance obligation.

Entries to Record Redemption of Loyalty Points

	<u>Dr.</u>	<u>Cr.</u>
Loyalty program - performance liability	\$ 400.00	
Other revenue from contracts with customers		\$ 400.00

Gaming Entity pays Retailer to fulfill point loyalty obligation

	<u>Dr.</u>	<u>Cr.</u>
Other revenue from contracts with customers	\$ 300.00	
Cash		\$ 300.00

Gaming Entity reacquires redeemed points from Retailer

Because Gaming Entity originally allocated \$400 of cash transactions to the loyalty point performance obligation, the total other revenue from contracts with customers ultimately recognized when a customer redeems at a third party is equal to the difference between the amount allocated to the performance obligation and the amount paid to the third party to fulfill it, which in this case is \$100.

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.