



November 4, 2019

The AICPA's Financial Reporting Executive Committee (FinREC) is requesting your feedback on this proposed wording that addresses gaming entities' determination of whether various pricing arrangements convey a lease under FASB ASC 842, *Leases*. The final content will be included in the 2020 edition of the AICPA Audit and Accounting Guide *Gaming*. Interested parties are encouraged to submit their informal feedback to Sharon Macey (Sharon.Macey@aicpa-cima.com) by December 19, 2019.

Proposed Wording to be Included in the Gaming Industry Guide:

Background

Types of gaming machine supply arrangements

1. Casino operators periodically enter into various arrangements under which they procure goods and related services from third-parties, typically the gaming machine manufacturer. Such arrangements may include participation and daily fee arrangements, wide area progressives ("WAP"s) and various utility products arrangements. In such arrangements, the manufacturer of the gaming equipment typically retains the title. Agreements between the casino operator and the manufacturer stipulate that the parties participate in the gaming activity by either sharing in the win or by the casino operator paying a fixed percentage of coin in or a flat fee to the manufacturer.

Determining whether an arrangement includes a lease

Identified assets and consideration of substitution rights

2. Under FASB ASC 842-10-15-9, an identified asset can be either implicitly or explicitly specified in a contract. The above arrangements typically identify the provided gaming equipment in the related contract. For a contract to meet the identified asset criteria, the gaming entity will also need to evaluate whether the manufacturer has a substantive right to substitute the underlying asset throughout the period of use. Such evaluation should be performed based on facts and circumstances existing at the inception of the contract.
3. A substitution right is considered substantive if both of the following conditions stipulated in FASB ASC 842-10-15-10 are met: (a) the manufacturer has the practical ability to substitute an alternative asset throughout the period of use and (b) the manufacturer would benefit economically from exercising its right of substitution. As described in FASB ASC 842-10-

15-14, substitution rights for warranty or maintenance provisions are not deemed substantive. The gaming entity will have to use judgment to determine if a substantive right of substitution is present; however, FASB ASC 842-10-15-15 contains the presumption that if the operator cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

4. Participation and daily fee arrangements, WAP and various utility products arrangements generally have substitution rights only when repairs or maintenance is required. A manufacturer’s right or obligation to substitute an asset for repairs or maintenance is not a substantive substitution right because there is no economic benefit to the manufacturer; therefore, FinREC believes that the substitution provisions typically included in such arrangements do not create a substantive substitution right because both of the criteria in FASB ASC 842-10-15-10 are not met.

Determination of whether a contract conveys the right to control the use of an identified asset

5. FASB ASC 842-10-15-4 requires that a contract must convey the right to control the use of an identified asset in order for that contract to contain a lease. To determine whether a contract conveys the right to control the use of an identified asset an entity shall assess whether, throughout the period of use, the customer has both of the following:
 - a. The right to obtain substantially all of the economic benefits from use of the identified asset; and
 - b. The right to direct the use of the identified asset.
6. If an entity determines that an arrangement contains a lease, it should then assess the lease term as described in paragraphs 7 through 10.

Determination of lease term

7. Determining the lease term of such arrangements will require significant judgment for both the operator and the manufacturer, and based on the specific facts and circumstances, the manufacturer/lessor and operator/lessee may reach different conclusions. When making its determination, the gaming entity should take into account all relevant economic factors, such as those provided in the example in FASB ASC 842-10-55-26.
8. Examples of economic factors a gaming entity may review in its assessment of the lease term are provided below:

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| Type of factor | Assessment of factors indicating renewals may be reasonably certain |
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|-----------------------|--|
| Contract-based | <ol style="list-style-type: none"> a. Below market renewal rates b. Options with significant economic value, including those only available in renewal periods |
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|---------------------|---|
| Asset-based | <ul style="list-style-type: none"> a. Significant operational disruption would result from termination b. Alternative equipment is significantly more expensive c. Platform is newly launched and replacements are limited |
| Entity-based | <ul style="list-style-type: none"> a. Operator is in a remote location making it difficult to acquire replacement machines b. Operator has made significant capital improvements incorporating the equipment in the design c. Prohibitive costs that become a significant economic penalty d. Highly specialized assets without adequate replacements e. At lease commencement, the operator views the specific equipment as essential which combined with other economic factors herein would create a significant economic penalty if alternative equipment is not readily available f. Considerations on how the slot gaming floor is managed and systems are replaced |
| Market-based | <ul style="list-style-type: none"> a. Regulations specific to a market may significantly limit supplier options b. Comparable asset lease rates are significantly higher c. Alternative assets are limited |

9. The factors noted above are not all encompassing. Accordingly, a gaming entity should assess any factors relevant to their arrangements that may ultimately impact the term of the arrangement.

10. Each gaming entity should perform its own assessment of the lease term and conclude on the basis of its own unique factors, which will require significant judgment. The lease term will be based on facts and circumstances related to contract based, market based, asset based and entity based factors.

Scoping and application of practical expedients

11. FASB ASC 842 includes various practical expedients that can be elected and applied by gaming entities that are generally expected to simplify the application of FASB ASC 842. Available practical expedients that directly impact the analysis of lease accounting for various arrangements discussed herein are:

- a. Short-Term Lease (FASB ASC 842-20-25-2) – a lessee may make an accounting policy election by class of underlying asset to not record on the balance sheet a lease if the term of the lease is twelve months or less and does not include a purchase option that the lessee is reasonably certain to exercise. Although ASC 842 does not address the term “class of underlying asset”, FinREC believes that determination of the class of underlying asset by the physical nature and characteristics of the asset would be reasonable.

- b. Lessee Separation of Nonlease Components (FASB ASC 842-10-15-37) – as a practical expedient, a lessee may make an accounting policy election by class of underlying asset to not separate nonlease components from lease components and instead account for the lease and nonlease components as a single lease component.
- c. Lessor Separation of Nonlease Components (FASB ASC 842-10-15-42A through 42C) – as a practical expedient, a lessor may, as an accounting policy election, by class of underlying asset to not separate nonlease components from lease components and, instead, to account for each separate lease component and the nonlease components associated with that lease component as a single component if the nonlease components otherwise would be accounted for under FASB ASC 606 and both of the following conditions are met: (a) the timing and pattern of transfer for the lease component and nonlease components associated with that lease component are the same and (b) the lease component, if accounted for separately, would be classified as an operating lease in accordance with paragraphs FASB ASC 842-10-25-2 through 25-3. A lessor that elects the practical expedient in paragraph FASB ASC 842-10-15-42A shall account for the combined component as a single performance obligation entirely in accordance with FASB ASC 606 if the nonlease component or components are the predominant component(s) of the combined component (i.e., the lessee would ascribe more value to the nonlease component(s) than the lease component). Otherwise, the combined component should be accounted for as an operating lease entirely in accordance with FASB ASC 842.

Participation and Daily Fee arrangements

- 12. Participation and daily fee arrangements will generally contain an asset that is explicitly specified in the contract as described in FASB ASC 842-10-15-9. If an agreement includes substitution rights that are for other than repairs and maintenance as described in paragraph 4, these rights must be evaluated to determine whether such rights are substantive under the criteria in FASB ASC 842-10-15-10.b. Based on the preceding, FinREC believes that participation and daily fee arrangements will generally contain an identified asset.
- 13. FinREC believes that an operator will generally conclude that it has the right to obtain substantially all of the economic benefits (thereby meeting criterion a. of FASB ASC 842-10-15-4) because it obtains substantially all of the primary outputs of the gaming machine for purposes of providing gaming entertainment to its customers as well as substantially all of the cash flows derived from the operation of the unit. FinREC also believes that criterion b.

of FASB ASC 842-10-15-4 will generally be met because the operator will make all relevant decisions regarding the use of the gaming machine, including determining the selected hold percentage after receipt of the gaming machine, location of the gaming machine, customer access, hours of operations and removal of the gaming machine from the gaming floor. Based on the preceding, FinREC believes that an operator will generally have the right to control the asset under participation and daily fee arrangements and therefore such arrangements contain a lease.

14. If an operator elects to apply the practical expedient to not separate lease and associated non-lease components, in accordance with FASB ASC 842-10-15-37, an operator would account for any service components within these arrangements as a single lease component. However, a lease component cannot be combined with another lease component absent appropriate application of a portfolio approach.
15. Depending on the conclusion that an operator reaches with respect to the term, an operator may be able to elect, as an accounting policy, the short-term lease recognition exemption provided in FASB ASC 842-20-25-2 and not record such leases on its balance sheet if the lease term is twelve months or less. Instead, the operator would recognize the lease payments in profit or loss on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred. Fees paid pursuant to these arrangements should be presented as an expense by the operator.

WAP arrangements

16. FinREC believes that a typical WAP arrangement will generally contain an identified asset that is explicitly specified in the contract as described in FASB ASC 842-10-15-9. If an operator's WAP agreements include substitution rights that are for other than repairs and maintenance as described in paragraph 4, these rights would have to be evaluated to determine whether such rights are substantive under the criteria in FASB ASC 842-10-15-10.b.
17. FinREC believes that an operator will generally conclude that it has the right to obtain substantially all of the economic benefits (thereby meeting criterion a. of FASB ASC 842-10-15-4) because it obtains substantially all of the primary outputs of the gaming machine for purposes of providing gaming entertainment to its customers and it obtains substantially all of the cash flows from the operation of the unit. FinREC also believes that criterion b. of FASB ASC 842-10-15-4 will be met based on the operator's rights which include determining the selected hold percentage (which are often subject to regulatory restrictions and thus not entirely within the operator's discretion) after receipt of the gaming machine, location of the gaming machine, customer access, hours of operations and removal of the gaming machine from the gaming floor. Based on the preceding, FinREC believes that a

manufacturer and operator would conclude that WAP arrangements convey the right to control the use of an identified asset to the operator and therefore contain a lease.

Operator Accounting

18. If the operator determines that a WAP arrangement contains a lease, an operator/lessee must assess the underlying lease term embedded in the WAP arrangement. Accordingly, each gaming entity should perform its own assessment and conclude according to its unique factors, which will require significant judgment. The lease term will be based on facts and circumstances related to contract based, market based, asset based and entity based factors. If the leases contained in a WAP arrangement are determined to be short-term by the operator and the short-term policy lease recognition accounting policy election, the operator does not record such leases on its balance sheet. Even if a WAP arrangement lease does not qualify for the short-term policy election or the operator chooses not to elect it, in most cases, WAP arrangements are 100% variable fee arrangements (e.g. percentage of coin in with no other fixed payments or other consideration that would be recognized at lease commencement) and, therefore, such arrangements would not be recorded on the balance sheet as these variable lease payments would be excluded when measuring lease assets and lease liabilities. For WAP arrangements recorded on the balance sheet as a lease, a lessee may make an accounting policy election to not separate the nonlease components (WAP offering) from the lease components (WAP gaming machine) and instead account for the lease and nonlease components as a single lease component. An operator should assess whether the facts and circumstances of its WAP arrangements are consistent with this chapter before reaching its conclusions.

Manufacturer Accounting

19. A WAP arrangement generally includes both the WAP offering (“nonlease component”) and a WAP gaming machine (“lease component”). The manufacturer should allocate the consideration in the arrangement to the separate lease and nonlease components using the requirements in paragraphs FASB ASC 842-30 and FASB ASC 606-10-32-28 through 32-41. The manufacturer may elect a practical expedient in accordance with FASB ASC 842-10-15-42A to not separate the nonlease component from the lease component and account for the arrangement as a single component if each of the following is true:

- a. the WAP offering is otherwise accounted for under FASB ASC 606 on revenue from contracts with customers; the
- b. timing and pattern of transfer for both the WAP offering and the WAP gaming equipment are the same; and

- c. the WAP gaming machine if accounted for separately, would be classified as an operating lease in accordance with paragraphs FASB ASC 842-10-25-2 through 25-3.

If the manufacturer qualifies for and elects the practical expedient to account for the arrangement as a single component and the nonlease component is the predominant component in the arrangement, the manufacturer should account for the combined components in accordance with FASB ASC 606. Otherwise, the manufacturer must account for the combined component as an operating lease entirely in accordance with FASB ASC 842. In determining whether the WAP offering is the predominant component, the manufacturer shall consider whether operator would be reasonably expected to ascribe more value to the WAP offering than to the WAP gaming equipment.

Utility products arrangements

20. Utility products arrangements include equipment supplied to operators with the title generally retained by the manufacturer. FinREC believes that utility products arrangements will generally contain an identified asset as described in FASB ASC 842-10-15-9, as relevant information including model and type is explicitly specified in these arrangements. If an agreement includes substitution rights other than for repairs or maintenance as described in paragraph 4, these rights would have to be evaluated to determine whether such rights are substantive under the criteria in FASB ASC 842-10-15-10.b. Based on the preceding, FinREC believes that utility products arrangements will generally contain an identified asset.
21. FinREC believes that an operator will generally conclude that it has the right to obtain substantially all of the economic benefits of the utility products because the operator obtains substantially all of the primary outputs by using the utility products for purposes of enhancing table game speed, productivity, profitability, and security. FinREC believes that an operator has the right to direct the use of the utility products throughout the period of use including when and where to use the utility products. Therefore, FinREC believes that most utility products arrangements will contain a lease.
22. Utility product arrangements generally include ongoing maintenance. A lessee may elect to combine the lease and nonlease components in accordance with FASB ASC 842-10-15-37. FinREC believes that the ongoing maintenance would generally not be considered a predominant component, therefore a lessor that qualifies (by class of underlying asset) for the election to combine lease and nonlease components may elect to combine such lease and nonlease components in accordance with FASB ASC 842-10-15-42A-42C but will be required to account for such arrangements entirely as an operating lease under FASB ASC 842.
23. The gaming entities (both operators and manufacturers) will have to use significant judgment to determine a lease term. In evaluating the lease term, gaming entities should consider not

only the noncancelable term, which for these arrangements is generally on a month-to-month basis, but also evaluate whether it is reasonably certain that renewal options would be exercised. All specific facts and circumstances should be considered and conclusions by operators and manufacturers may not be aligned.

24. Gaming entities must take into consideration any relevant factors that create an economic incentive for the lessee to exercise lease renewal or termination as well as other direct and indirect factors as may be applicable. Each gaming entity should perform its own assessment on lease term and conclude according to its unique factors, which will require significant judgment based on facts and circumstances related to contract based, market based, asset based and entity based factors. Some factors that are common to utility products may include a low level of customization, minimal installation and/or relocation costs, a relatively low importance within the context of overall gaming operations, minimal operational disruption in case of termination and the availability of replacement or alternative methods (e.g. hand shuffling). FinREC believes that most utility products arrangements will generally contain a lease with the lease term varying based on the terms of the underlying agreement including renewal terms if determined to be reasonably certain based on facts and circumstances.