STAFF PAPER

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Project	**FASB/IASB Joint Transition Resource Group for Revenue Recognition**
Paper topic	Whether Fixed Odds Wagering Contracts are Included or Excluded from the Scope of Topic 606

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Purpose

1. Some stakeholders informed the FASB staff that there are questions about whether fixed odds wagering contracts are in the scope of Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (the new revenue standard). Some stakeholders have requested that the FASB clarify whether fixed odds wagering contracts are in the scope of the new revenue standard or in the scope of Topic 815, Derivatives and Hedging. This paper includes a summary of the implementation question that those stakeholders have reported to the staff. The staff plan to ask the members of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG) for their input about the implementation question.
2. The topic discussed in this paper applies only to U.S. GAAP because today gaming entities apply the guidance in Subtopic 924-605, Entertainment—Casinos—Revenue Recognition, to fixed odds wagering contracts and that guidance was superseded by the new revenue standard. IFRS considerations are summarized in Appendix A.

Background

3. Gaming entities participate in games of chance with customers, with both the gaming entity and the customer having the chance to win or lose money or other items of economic value based on the outcome of the game. Those activities are referred to as "gaming activities." Examples of gaming activities include table games, slot machines, keno, bingo, sports and non-pari-mutuel[1] race betting. The payout for wagers placed on gaming activities typically is known at the time the wager is placed. This form of wagering is referred to as "fixed odds wagering." Fixed odds wagers typically comprise a significant portion of a gaming entity's transactions.
4. Gaming entities also participate in games in which a customer has the chance to win or lose money or other items of economic value, with the gaming entity receiving a fee (typically, either a fixed fee or a percentage of play) for administering the game, rather than the gaming entity being at risk to win or lose based on the outcome of the game. Examples of games that typically are played as gaming related activities include card games, certain tournaments, lotteries, and pari-mutuel race betting.
5. Wagers on gaming and gaming related activities may relate to current or future events. Wagers related to current events are typically settled immediately (or within a 24-hour period). Wagers related to future events generally settle at the time of the event when the outcome of the event is determined.
6. Under U.S. GAAP, revenue from gaming and gaming related activities generally is recognized when the wager is settled. For example, revenue for a wager on a current event is recognized soon after the wager is made. Conversely, a fixed odds wager on a future event is first recognized as deferred revenue at the time the wager is placed. When the event occurs, the gaming entity determines the amount due to winners, recognizes a liability to those winners, derecognizes deferred revenue and the resulting net debit or credit (that is, the amount by which the gaming entity has profited or lost from the wager) is recognized as net gaming revenue.
7. Some gaming entities also offer customers hotel accommodations, food, and/or beverage services. Those services and accommodations may be provided to

[1] Pari-mutuel betting is a betting system in which all bets are placed together in a pool. Payoff odds are not fixed at the time a wager is placed. Rather, the final payout is determined when the pool is closed and is shared among all winning bets. A gaming entity acts only as an agent in these arrangements and collects a fee for administering the bets.

customers based on a market rate or may be given to certain customers without charge or at a discount as part of promotion. Revenue resulting from services and accommodations generally is recognized at the time those services or accommodations are provided. If the services or accommodations are provided as a promotion, then the retail amount of the promotion typically is included in gross revenues and offset by deducting the promotion from gross revenues on the face of the income statement.

Accounting Guidance

8. Subtopic 924-605 includes authoritative revenue guidance for casinos. Section 924-605-20 defines gross gaming revenues (also referred to as a “win”) as “the net win from gaming activities, which is the difference between gaming wins and losses before deducting costs and expenses.”
9. Paragraph 924-605-45-1 explains that promotional allowances (for example, food and beverages) represent goods and services, which would be accounted for as revenue if sold, that a casino gives to customers as an inducement to gamble at that establishment. Paragraph 924-605-45-2 explains that promotional allowances should be recognized as a reduction from gross revenues on the face of the income statement.
10. The AICPA *Audit and Accounting Guide – Gaming* (AICPA AAG) includes additional non-authoritative guidance for the gaming industry. Chapter 3 of the AICPA AAG explains that gross gaming revenue is the difference between gaming wins and losses from banked games before deducting incentives or adjusting for changes in progressive jackpot liability accruals.
11. Appendix C of the AICPA AAG includes illustrative financial statements of a nongovernment hotel-casino and a governmental hotel-casino. In the summary of significant accounting policies footnotes to those financial statements, revenue recognition and promotional allowances are described as follows: “Gaming revenue is (a) the win from gaming activities, which is the difference between gaming wins and losses, less sales incentives and other adjustments, and (b) revenue from gaming related activities such as poker, pari-mutuel wagering, and tournaments.”

12. Paragraph 606-10-15-2 states that the new revenue standard shall apply to all contracts with customers, except the following:
    a. Lease contracts within the scope of Topic 840, Leases.
    b. Insurance contracts within the scope of Topic 944, Financial Services—Insurance.
    c. Financial instruments and other contractual rights or obligations within the scope of the following Topics:
        1. Topic 310, Receivables
        2. Topic 320, Investments—Debt and Equity Securities
        3. Topic 323, Investments—Equity Method and Joint Ventures
        4. Topic 325, Investments—Other
        5. Topic 405, Liabilities
        6. Topic 470, Debt
        7. Topic 815, Derivatives and Hedging
        8. Topic 825, Financial Instruments
        9. Topic 860, Transfers and Servicing.
    d. Guarantees (other than product or service warranties) within the scope of Topic 460, Guarantees.
    e. Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Topic would not apply to a contract between two oil companies that agree to an exchange of oil to fulfill demand from their customers in different specified locations on a timely basis. Topic 845 on nonmonetary transactions may apply to nonmonetary exchanges that are not within the scope of this Topic.

Question: Are fixed odds wagering contracts included in the scope of Topic 606?

13. The new revenue standard supersedes virtually all existing revenue guidance in U.S. GAAP. Accordingly, upon the effective date of the new revenue standard, the revenue guidance in Subtopic 924-605 would no longer be applied in practice. The scope of the new revenue standard excludes certain contracts, including those in the scope of Topic 815.

14. Because the new revenue standard does not include explicit guidance similar to current U.S. GAAP that specifically identifies fixed odds wagering as gaming revenue, some stakeholders have questioned whether fixed odds gaming contracts are in the scope of the new revenue standard or should be accounted for as derivatives within the scope of Topic 815. This question has arisen, in part, because in 2007 the then International Financial Reporting Interpretations Committee (IFRIC) considered a submission relating to the accounting for wagers received by a gaming entity. The IFRIC noted that when a gaming entity takes a position against a customer (that is, a fixed odds wager), the resulting unsettled wager is a financial instrument that is likely to meet the definition of a derivative financial instrument and should be accounted for under IAS 39 *Financial Instruments: Recognition and Measurement*. The IFRIC also noted that there may be situations in which a gaming entity does not take positions against customers, but instead provides services to manage the organization of games between two or more gaming parties. In those situations, the gaming entity earns a commission for those services, regardless of the outcome of the wager. The IFRIC noted that such a commission was likely to meet the definition of revenue and would be recognized when the conditions in IAS 18 *Revenue* are met.

15. The FASB staff does not think it was the FASB's intent to exclude fixed odds wagering contracts from the scope of the new revenue standard. Rather, the FASB staff thinks the FASB's intent was for fixed odds contracts to continue to be accounted for as revenue transactions.

16. As a point of reference, if fixed odds wagering contracts were excluded from the scope of the new revenue standard, then those arrangements likely would be accounted for as derivatives in accordance with Topic 815. Under Topic 815, an entity is required to estimate the fair value the derivative instrument on a recurring basis. Changes in the fair value of the derivative instrument would be recognized as revenue. However, the changes in the fair value of the derivative likely would be presented as a separate component of revenue. As a result, the revenue presented by gaming entities with a significant number of fixed odds wagering contracts would be primarily comprised of a net derivative gain or loss (that is, the amount of gaming revenue presented by gaming entities would be significantly reduced as compared to current U.S. GAAP).

17. Topic 815 also requires a series of disclosures regarding derivatives. Those disclosures generally focus on hedging activities, the purpose of those hedging activities, and other information. In addition, because Topic 815 requires derivatives to be measured at fair value on a recurring basis, gaming entities also would have to provide the disclosures required by Topic 820, Fair Value Measurement.

Question for the TRG Members
1. Do the TRG members agree with the FASB staff's view in this paper?

Appendix A: IFRS Considerations

18. Although this question has been raised in the context of U.S. GAAP and the staff have not received any questions on IFRS related to this issue, the staff thought it might be helpful to summarize the IFRS considerations on this topic.

19. Paragraph 5 of IFRS 15 includes a scope exclusion for financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement* if the entity has not yet applied IFRS 9).

20. The IFRS Interpretations Committee (formerly the IFRIC) has previously noted that some wagers of a gaming institution are financial instruments that are likely to meet the definition of a derivative financial instrument and should be accounted for under the financial instruments Standard (IFRS 9 or IAS 39). The IFRIC's agenda decision included in the July 2007 *IFRIC Update* was as follows:

IAS 39 Financial Instruments: Recognition and Measurement—Gaming transactions

The IFRIC considered a submission relating to the accounting for wagers received by a gaming institution.

The IFRIC noted the definitions of financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*, and the application guidance in paragraph AG8 of IAS 32. It noted that when a gaming institution takes a position against a customer, the resulting unsettled wager is a financial instrument that is likely to meet the definition of a derivative financial instrument and should be accounted for under IAS 39.

In other situations, a gaming institution does not take positions against customers but instead provides services to manage the organisation of games between two or more gaming parties. The gaming institution earns a commission for such services regardless of the outcome of the wager. The IFRIC noted that such a commission was likely to meet the definition of revenue and would be recognised when the conditions in IAS 18 *Revenue* were met.

The IFRIC did not consider that there was widespread divergence in practice in this area and therefore decided not to take the issue on to its agenda.

21. Therefore, the IASB staff thinks that wagering contracts (or part thereof) that meet the definition of a financial instrument within the scope of IFRS 9 (or IAS 39) are excluded from the scope of IFRS 15.