# Issue

Services have reached agreements in which one Service runs the operations of a certain program on behalf of the other Services, and then distributes the net profits to the other Services. The Services which are not running the operations of the program own significant portions of the assets used by the program, and are thus entitled to a share of the profits earned from the program. An example of this type of program is Gaming (run by Army).

These arrangements are not prohibited by DoD policy and the FMR, but no guidance exists on how to properly account for these arrangements, and thus the Service’s methods of accounting for these arrangements is not standardized. Note that this position paper relates only to programs run by the Services and not programs run by a third party (i.e., American Travel Forces run by Priceline). Programs run by a third party are addressed in a separate position paper.

GAAP provides a series of potentially relevant relationships which depend on factors such as control, participation, and status as an entity.

# Research

Below outlines the accounting of revenues and expenses related to other service managed revenue, how each Service complies and what the regulations, accounting guidance and industry standards are for this area.

| Other Service Managed Revenue Treatment and Guidelines | Air Force | Army | | Navy | Marines |
| --- | --- | --- | --- | --- | --- |
| Services’ Process for Other Service Managed Revenue | Need more information. | | Runs Gaming Program.  Need more information on broader treatment. | Gaming Revenues and Expenses placed in Gaming 407 OSD account.  Need more information on broader treatment. | Gaming revenues are included in Gross Sales  Need more information on broader treatment. |
| DoDI1015.10:  No prohibitions against Other Service Managed Revenue arrangements.  E2.5.F: Responsibilities of Chiefs of Military Services  F. Facilitate ongoing cooperative efforts and joint MWR programming between the Service exchanges and among the military MWR organizations; report to the PDUSD(P&R) on the status of such initiatives in conjunction with the annual MWR program review. | Need more information. | | Need more information. | Need more information. | Need more information. |
| DODI 1015.15: Silent on Treatment. | N/A | | N/A | N/A | N/A |
| DODI 4000.19 E.3.4.b Common Support Agreements  Military Departments may provide services and supplies and may perform work in support of one another and to the U.S. Coast Guard without reimbursement if the Secretaries concerned concur, pursuant to section 2571 of Reference (f). | Need more information. | | Need more information. | Need more information. | Need more information. |
| FMR: Silent on Treatment. | N/A | | N/A | N/A | N/A |
| GAAP: FASB 808 Collaborative Agreements:  A contractual arrangement that involves a joint operating activity. These arrangements involve two (or more) parties that meet both of the following requirements:  a. They are active participants in the activity  b. They are exposed to significant risks and rewards dependent on the commercial success of the activity (see paragraphs 808-10-15-10 through 15-13. (Master Glossary)  808.10.15.4-13:  A collaborative arrangement within the scope of this Topic is not primarily conducted through a separate legal entity created for that activity. However, in some situations part of a collaborative arrangement may be conducted in a legal entity for specific activities or for a specific geographic location. The existence of a legal entity for part of an arrangement does not prevent an arrangement from being a collaborative arrangement. The part of the arrangement that is conducted in a separate legal entity shall be accounted for under the guidance in Topic 810.  15-6 Participants shall evaluate whether an arrangement is a collaborative arrangement at its inception based on the facts and circumstances specific to the arrangement. However, a collaborative arrangement can begin at any point in the life cycle of an [endeavor](http://www.accountingresearchmanager.com/?wkru=https%3A%2F%2Fsts.us.gt.com%2Fadfs%2Fls%2Fauth%2Fintegrated%2F%3FSAMLRequest%3DfZDLasJAFIZfJczeZCIthkMSCA2FgIpokdLdMA4mOJc45wyxffpOYxd20%252F3%252F%252FbcShdEjNIF6u1fXoJCSo%252FI4OFuxZcpZ0rUV0%252F56EV%252Frvenez7fN7tTl5rDFduyPGAWIQXUWSViKDM%252BLBX9a5MXbkgN%252FBl6k%252BWr1wZJX56WagypGPiiW3Iy2CHODigVvwQkcEKwwCoEkHJrNGmIJGL0jJ51mdfmjhjnSP%252FD%252F4wJReYqTWN0TjQhZpt15sOnkNMWxFx0m5VPpTJk9%252BN%252FDRthGw67dOT3Iz6TR2k0vXglSvzOy%252Bk79fbH%252BBg%253D%253D%26RelayState%3DihKFBSRIWT52VJlxVxDpMXDVTV3eAH#/r/0F8C085C351A0F36862575A9000DD460?checkId=1) . Participants shall reevaluate whether an arrangement continues to be a collaborative arrangement whenever there is a change in either the roles of the participants in the arrangement or the participants' exposure to significant risks and rewards dependent on the ultimate commercial success of the endeavor. For example, the exercise of an option could change a participant's role in the arrangement or its exposure to risks and rewards.  > > Joint Operating Activity  15-7 The joint operating activities of a collaborative arrangement might involve joint development and commercialization of intellectual property, a drug candidate, software, computer hardware, or a motion picture. For example, a joint operating activity involving a drug candidate may include research and development, marketing (including promotional activities and physician detailing), general and administrative activities, manufacturing, and distribution. However, there may also be collaborative arrangements that do not relate to intellectual property. For example, the activities of a collaborative arrangement may involve joint operation of a facility, such as a hospital. A collaborative arrangement may provide that one participant has sole or primary responsibility for certain activities or that two or more participants have shared responsibility for certain activities. For example, the arrangement may provide for one participant to have primary responsibility for research and development and another participant to have primary responsibility for commercialization of the final product or service.  > > Active Participation  15-8 Whether the parties in a collaborative arrangement are active participants will depend on the facts and circumstances specific to the arrangement. Examples of situations that may evidence active participation of the parties in a collaborative arrangement include, but are not limited to, the following:  a. Directing and carrying out the activities of the joint operating activity  b. Participating on a steering committee or other oversight or governance mechanism  c. Holding a contractual or other legal right to the underlying intellectual property.  15-9 An entity that solely provides financial resources to an endeavor is generally not an active participant in a collaborative arrangement within the scope of this Topic.  > > Significant Risks and Rewards  15-10 Whether the participants in a collaborative arrangement are exposed to significant risks and rewards dependent on the commercial success of the joint operating activity depends on the facts and circumstances specific to the arrangement, including, but not limited to, the terms and conditions of the arrangement.  15-11 The terms and conditions of the arrangement might indicate that participants are not exposed to significant risks and rewards if, for example:  a. Services are performed in exchange for fees paid at market rates.  b. A participant is able to exit the arrangement without cause and recover all (or a significant portion) of its cumulative economic participation to date.  c. Initial profits are allocated to only one participant.  d. There is a limit on the reward that accrues to a participant  15-12 Other factors that shall be considered in evaluating risks and rewards include:  a. The stage of the endeavor's life cycle  b. The expected duration or extent of the participants' financial participation in the arrangement in relation to the endeavor's total expected life or total expected value.  15-13 Many collaborative arrangements involve licenses of intellectual property, and the participants may exchange consideration related to the license at the inception of the arrangement. Such an exchange does not necessarily indicate that the participants are not exposed to significant risks and rewards dependent on the ultimate commercial success of the endeavor. An entity shall use judgment in determining whether its participation in an arrangement subjects it to significant risks and rewards.  45-2 For costs incurred and revenue generated from third parties, the participant in a collaborative arrangement that is deemed to be the principal participant for a given transaction under Subtopic 605-45 : shall record that transaction on a gross basis in its financial statements.  Participants in a [collaborative arrangement](http://www.accountingresearchmanager.com/#/r/5C65D9B4738B8788862575A9000B7AAE?checkId=1) shall report costs incurred and revenue generated from transactions with third parties(that is, parties that do not participate in the arrangement) in each entity's respective income statement pursuant to the guidance on principal versus agent considerations in paragraphs 606-10-55-36 through 55-40 : . An entity shall not apply the equity method of accounting under Subtopics 323-10 : and 323-30 : to activities of collaborative arrangements  45-3 Payments between participants pursuant to a collaborative arrangement that are within the scope of other authoritative accounting literature on income statement classification shall be accounted for using the relevant provisions of that literature. If the payments are not within the scope of other authoritative accounting literature, the income statement classification for the payments shall be based on an analogy to authoritative accounting literature or if there is no appropriate analogy, a reasonable, rational, and consistently applied accounting policy election. | Pending question of “active participants” | | Pending question of “active participants” | Pending question of “active participants” | Pending question of “active participants” |
| GAAP: FASB 323 Unincorporated Joint Venture  FASB 323.30.25.1.  Investors in unincorporated entities such as partnerships and other unincorporated joint ventures generally shall account for their investments using the equity method of accounting by analogy to Subtopic 323-10 : if the investor has the ability to exercise significant influence over the investee. | Alternative to Collaborative arrangement | | Alternative to Collaborative arrangement | Alternative to Collaborative arrangement | Alternative to Collaborative arrangement |
| According to EITF Issue 07-1, the following activities, among others, may comprise evidence of active participation in an arrangement:   * Participating in the governance and oversight of the arrangement, such as serving on a steering committee * Directing and carrying out the activities of the joint operating activity * Holding a contractual or other legal right to the underlying intellectual property |  | |  |  |  |
| FASAB Handbook version 16: S  Silent on treatment of joint ventures between government departments- discusses public-private joint venture. | N/A | | N/A | N/A | N/A |
| Industry Practice: Degree of ownership in the joint venture is determined by the value of the assets contributed or the amount of stock purchased, as well as amount of control, liquidation rights, and capitalization status. | N/A | | N/A | N/A | N/A |

# Discussion

The treatment of these programs hinges on two important questions

1. Do the contributing Services provide more than just financial resources for the program operations, and therefore qualify as an Active participant?
2. Do the contributing Services have the ability to exert significant influence upon the program operations?
3. Is the program a separate entity?

Based on the information available, Grant Thornton believes the contributing Services do qualify as an Active participant. It is our understanding that the Services can exert authority over their own gaming assets to make disposition and acquisition decisions, where gaming operations can take place, and how resources provided are to be used. It is important to note that Other Service Managed Revenue arrangements are not contractually binding, and the contributing Service’s choice not to exert authority over these matters does not mean that the authority does not exist. This simultaneously answers the question of significant influence.

Grant Thornton is not aware of the full extent of management role or other items such as employee arrangements that are relevant to this determination. However, it is our understanding that a program run by Air Force with assets contributed by Navy could not legally prevent Navy from exerting influence over the program operations without an explicit agreement by the Services.

Regarding the entity question, gaming operations are one of several programs offered by the Services as defined by policy, and share common support function support with those other programs. Secondly, there is no ownership stock. We believe there is also no separate governance from other programs as installation leadership presumably presides over gaming operations in addition to other MWR programs. Thus, the program is not a separate entity.

# .Recommendation

With these conclusions in mind, we view the Services as Active participants with ability to exert significant influence on program operations, and those programs do not constitute distinct entities. Therefore, the Other Service Managed Programs should be accounted for as collaborative arrangements.

Standards regarding accounting for Collaborative Agreements are still under development and have been for the past decade. The FASB has convened on this issue as recently as February 2018. Among the core considerations:

1. Any principal/ agent relationship should divide the sales revenue from any commission charged.
2. Sales and Expenses on a particular transaction should be attributed to one of the collaborating entities. This is due to fact that the collaboration itself does not constitute a separate entity.
3. Payments between collaborating entities are too broad for prescriptive treatment; entities should consult accounting literature for an analogous example and then apply the chosen accounting method consistently.

For the purposes of Other Service Managed Revenue programs, there are key considerations to take into account before deciding upon an accounting method. Unlike the exchange dividend, the profit distribution affects three out of four Services, and may be a distributed loss in poor performing years. In the case of gaming, if Army were to record all of the transactions at gross and then distribute at net, the total revenues and total expense accounts will be higher than reality for Army and lower than reality for the other Services. The Army could allocate the gross sales and gross expenses related to gaming to each Service in the proper portions, but that may be a burdensome reporting requirement.

With these considerations in mind, we recommend that Other Service Managed Revenue be recorded by the primary Service at gross. Continuing with the gaming example, Army will record all sales to third parties. On the cost side, the Army will record all costs related to what it provided to the collaborative arrangement- which would be all operating costs except for depreciation as the other Services provided only assets to the arrangement. Additionally, the Army will record the amount due to the other Services as an operating expense reducing the amount of profit/loss received from gaming operations to Army’s portion. Assuming all Services’ gaming operations earn and incur 25% of all revenues and expenses, note the example below:

Army’s (Primary Service) Income Statement Other Service Income Statement

Sales (100% of Gaming Sales) 100k Collaborative Arrangement Rev 4.33k

COGS (100%) (80k) COGS (0%) (0)

Gross Profit= 20k Gross Profit (0%) 4.33k

SG&A (100%) (4k) SGA (0%) 0

Collaborative Arrangement Exp (13k) Depreciation (33%) 1.33k

Net Income 3k Net Income 3k

This example is based off another from the FASB website on Collaborative Arrangements in FASB 808.10.55.4-14. We believe it accurately portrays the responsibilities of each party in regards to the operation of the gaming program. For example, Army truly is creating 100% of the gaming sales, and by virtue of running the program, is incurring 100% of the costs to create those sales with the exception of depreciation. Army’s financials are showing the underlying economic event of Army generating the sale, incurring the cost, and distributing the profits to the other Services. Sales are not double counted in any instance, and the net income figures are properly reported by all parties. There is no need to create separate Collaborative Arrangement Revenue GLACs to show the difference between Collaborative Arrangement Revenues from different programs as the distinction can be made via the activity.

Edits will be required to the FMR.

# Service Concurrence

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| --- | --- | --- |
| Service | Concurrence | Reason for Non-Concurrence |
| Air Force | **Concurred 10/25/2018.** |  |
| Army | **Concurred 12/13/2018.** |  |
| Marines | **Concurred 10/25/2018.** |  |
| Navy | Concurrence on 10/25/18.**Re-concurred 12/13/2018.** |  |

# USD (P&R)/MC&FP Disposition

No further action.

# DFAS Disposition

Revise FMR.

# Forward to DoDIG?

No DoDIG equities.