Accounting for digitally distributed content

Media & Entertainment

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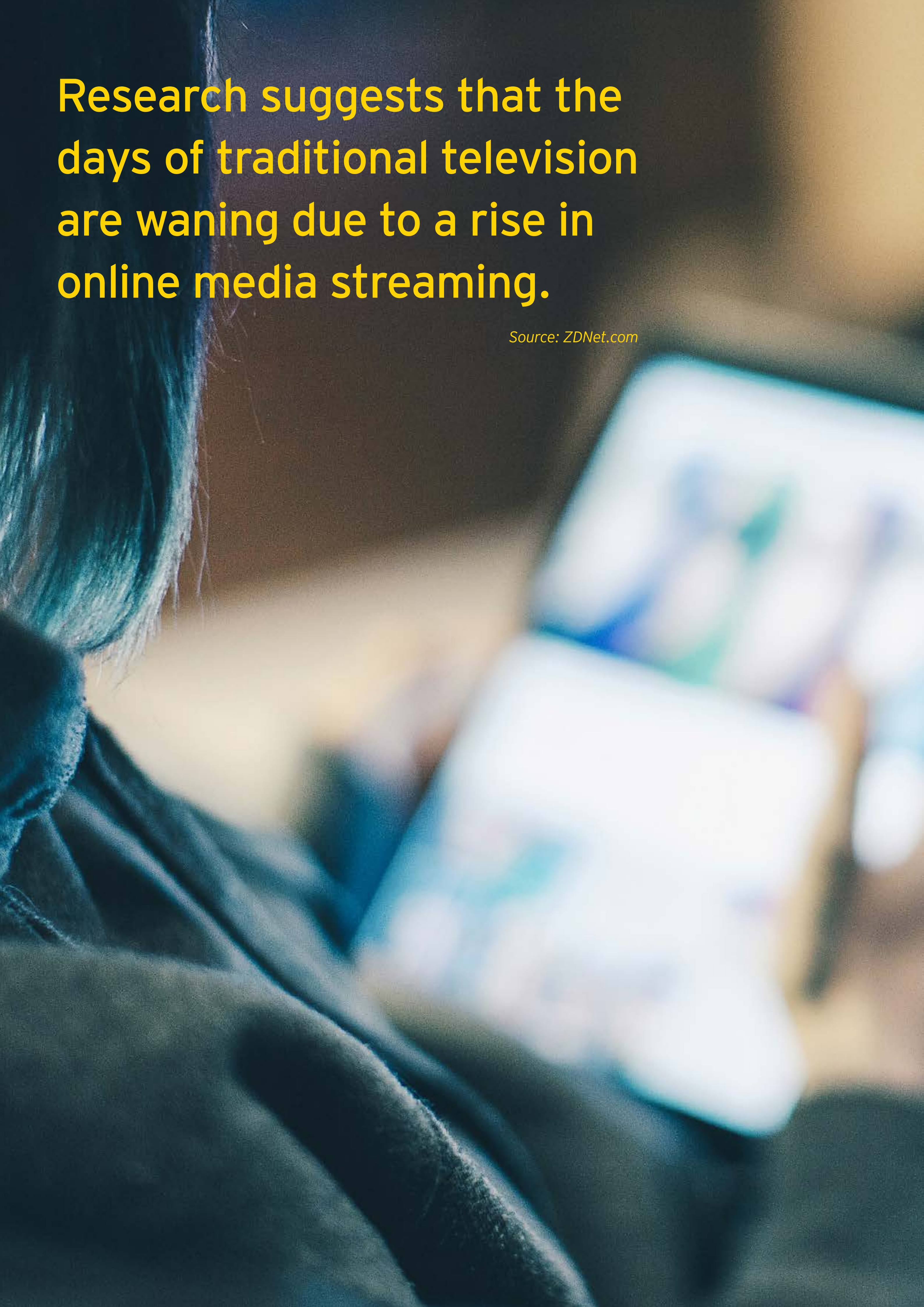


Research suggests that the days of traditional television are waning due to a rise in online media streaming.

Source: ZDNet.com

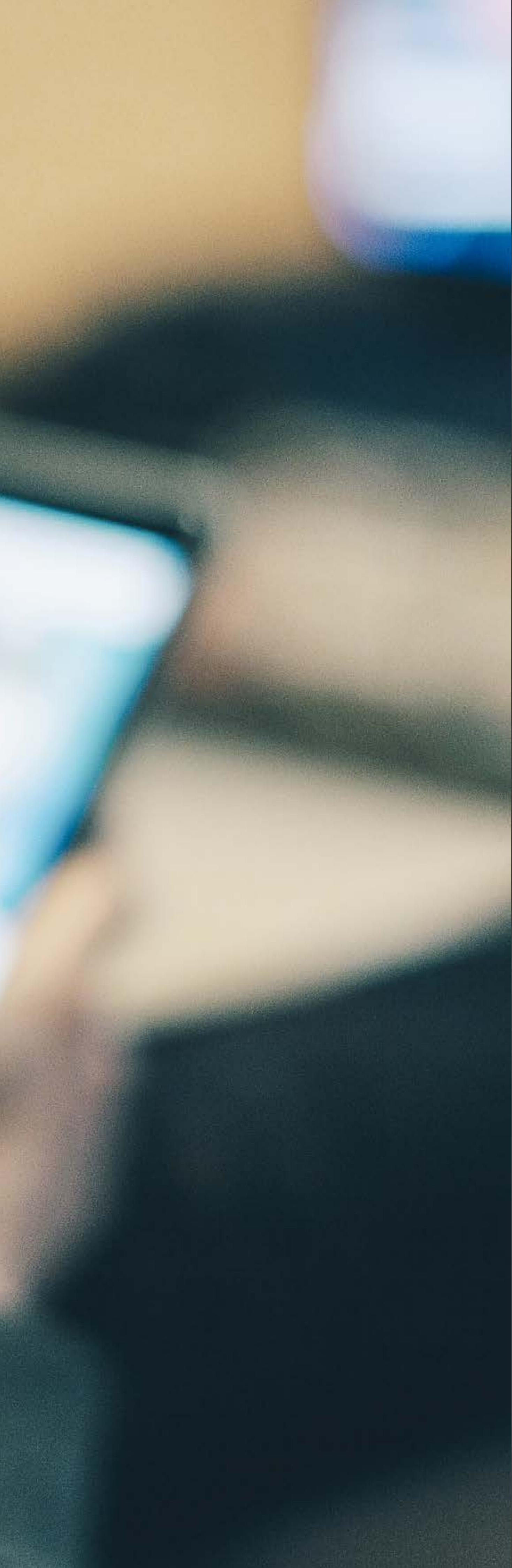


Table of contents

Introduction

For media and entertainment (M&E) companies, digital is transforming every facet of their business. The rise of social media, widespread broadband availability, faster internet connections, and the popularity of smartphones and tablets have changed the demands and expectations of media audiences and created an astounding variety of new digital products and services. Perhaps nowhere is the transformation as visible as in the growth of content that is accessible via digital services.

How should digital download and streaming service providers account for the licensing and production of movies and television shows?

Many of the digital download and streaming service providers (digital providers) that now offer movies and television shows (content) over the internet (digital services) are licensing content and creating their own content (digital content). What these entities are really doing isn't very different from what traditional broadcasters and producers of films or television shows have always done. They are distributing content in a different way. We therefore believe that entities that license or produce content to be distributed to consumers on a digital service generally should follow the M&E industry-specific accounting guidance that has historically been applied by traditional broadcasters and producers of films or television shows.

This publication describes considerations for entities that license or produce content for distribution on digital services. We expect new questions to arise as technology and business models continue to evolve. For the remainder of this publication, the term licensed content refers to the rights acquired under a license agreement for content (program material), and the term owned content refers to content owned (produced) by the entity.

This publication addresses considerations under US generally accepted accounting principles (GAAP), and differences may arise when applying accounting standards outside of the US.

Nowhere is the transformation as visible as in the growth of internet content streaming.

Accounting considerations for the license of content

1 *Should digital providers that license content apply Accounting Standards Codification (ASC) 920,[1] which addresses the accounting and reporting by a broadcaster licensee for the rights acquired under a license agreement?*

While ASC 920 has traditionally been applied by broadcasters that license content that they transmit over the airwaves and via cable and satellite networks, other types of digital providers have assessed whether they should apply it when they license content that will be transmitted/distributed via their digital services. ASC 920 defines a broadcaster as "an entity or an affiliated group of entities that transmits radio[2] or television program material." Entities that transmit licensed content via digital services apply the ASC 920 guidance, reasoning that the transmission of licensed content, regardless of the technical platform, is within the scope of ASC 920.

ASC 920 does not apply to broadcasters that own the content shown on their cable, network or local television outlets and we believe that, by extension, it would not apply to owned content that is distributed via digital services. The accounting for owned content is addressed in ASC 926.[3] See Chapter 3 for more details on the application of ASC 926.

2 *How is the license of content accounted for under ASC 920?*

A licensee of content that determines that it meets the definition of a broadcaster should record the licensed content and the related liability on the balance sheet once the license period begins and all of the following conditions have been met:

- The cost of each program is known or reasonably determinable.
- The program material has been accepted by the licensee in accordance with the license agreement.
- The program material is available for its first showing.

Entities make a policy election, which must be applied consistently, to initially record the asset and related liability for licensed content at either the fair value or gross amount of the liability. If a present value technique is used to determine the fair value, the difference between the gross and net liability is recorded as interest in accordance with ASC 835.[4]

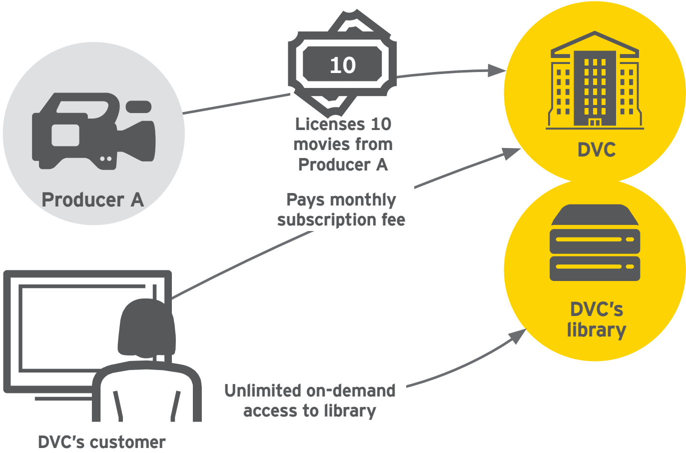
While it is generally easy to determine whether the program material has been accepted and is available for its first showing, determining when costs of each program are known or reasonably determinable may be more difficult. Agreements for licenses of content may be structured in a variety of ways, including:

- Fixed fee per title or series
- Fixed fee for an entire contract (e.g., a bundle of movies/television shows)
- Variable fee based on advertising (e.g., advertising metrics achieved, revenue sharing arrangements), subscription fees or number of views
- Variable fee based on advertising, subscription fees or number of views with a minimum guarantee
- A combination of fixed and variable fees

The variety of arrangements and combinations of fee structures can make the evaluation of when the cost of each program is known or reasonably determinable even more challenging. The capitalized costs should be allocated to the individual programs within a package on the basis of relative value of each program. The following illustration provides typical scenarios.

1 ASC 920, *Entertainment — Broadcasters*.
2 For further guidance on accounting for radio arrangements, refer to ASC 928, *Entertainment — Music*.
3 ASC 926, *Entertainment — Films*.
4 ASC 835, *Interest*.

Illustration 1 — assessing whether the cost of each program is known or reasonably determinable when the arrangement has predetermined titles



Digital Video Co. (DVC) licenses 10 movies from Producer A for a two-year period. DVC provides its customers with unlimited on-demand access to this library of digital content viewed over the internet in exchange for a monthly subscription fee.

The following scenarios describe common payment terms for the license of content and the appropriate accounting:

Scenario 1

Upon delivery and its acceptance of the 10 movie titles, DVC will pay a total of $1 million (or $100,000 per movie as specified in the contract and separately determined to be the value of each licensed title) for the unlimited right to broadcast the content for two years (the license period). Because the contract price is fixed and the cost of each program is known, the total amount of $1 million would be capitalized at the beginning of the license period when the content is available for streaming. If the fee per title was not specified in the contract (or was not an approximation of the value of each right), DVC would allocate the $1 million fee on a relative fair value basis to each title and capitalize accordingly.

Scenario 2

In addition to paying $1 million for the unlimited right to broadcast the 10 movies for two years, DVC will pay Producer A an incremental fee of $1 for each online stream of a movie from this library. In this case, similar to Scenario 1, DVC would capitalize $1 million at the beginning of the license period and would amortize it upon streaming (i.e., it is expensed as incurred). Fees DVC pays after each movie has been streamed online would be expensed immediately as each movie was streamed.

Scenario 3

Upon delivery and its acceptance of the 10 movies, DVC will pay Producer A one percent of the subscription fees it collects from its monthly subscribers over the next two years. Because the cost associated with each title is not known and there is significant uncertainty as to future monthly billings under month-to-month subscriber agreements, DVC would not capitalize any of the license fees (i.e., it would not record licensed content and the related liability when the movies have been delivered and are available for showing). Instead, DVC would expense the license fees when the programs are streamed.

More complex scenarios, including those with additional variability in payments (e.g., variable license payments that increase or decrease over time or that are phased in or out depending on viewership), should be considered carefully, not only to determine when (or if) the related license asset and liability are recorded but also the subsequent amortization of the license asset. See Chapter 3 for further details on how different types of digital content should be amortized under ASC 920.

3 *How should different types of digital content be amortized under ASC 920?*

Capitalized costs of license agreements are amortized under ASC 920 based on the estimated number of future showings, except for licenses with unlimited showings, which may be amortized over the period of agreement because the estimated number of future showings may not be determinable.

The unit of account should be determined prior to selecting the appropriate method of amortization. ASC 920 provides for the following:

Type of content licensed	Program-by-program basis	Amortized as a series
Feature programs (e.g., current releases) Episodic television (e.g., first run or available)	✓	
Program series and other syndicated products		✓

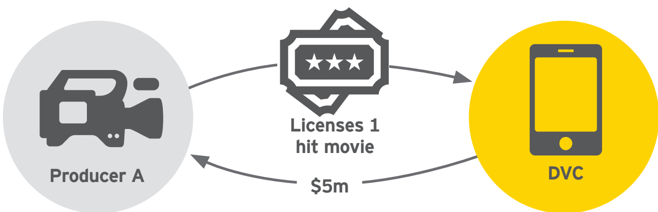
Feature programs can be amortized, in accordance with ASC 920, on an aggregated basis if they approximate the amortization under the program-by-program basis.

ASC 920 provides for the following amortization methods to be applied based on the expected future economic benefit to be earned:

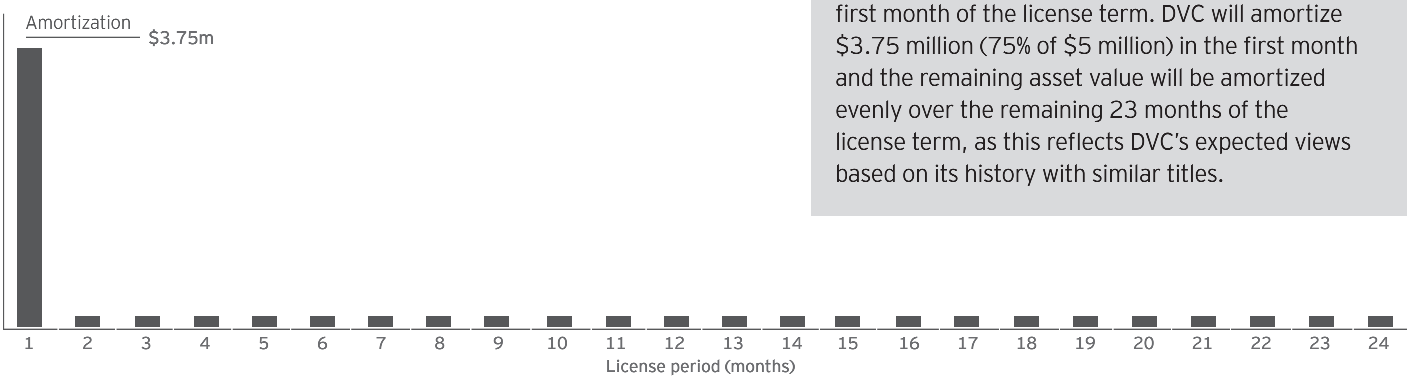
Method of amortization	Description
Accelerated amortization	Under this method, amortization is recorded based on the expected value of each airing. If the first showing is more valuable than reruns, an accelerated method of amortization may be more appropriate.
Straight-line	If each showing is expected to generate similar value, a straight-line amortization method may be more appropriate. Under this method, amortization is recorded evenly (typically over the shorter of the license period or estimated period of use).

When selecting the most appropriate method to amortize programming, the type of content, benefit to the entity and available viewing metrics that could be measured should also be considered.

Illustration 2 — accelerated amortization



DVC pays $5 million to license a feature program (a hit movie that is part of a successful franchise) for a two-year term from Producer A. The license provides DVC the exclusive US premiere rights to the title on its streaming platform. Based on viewer history with similar titles, DVC estimates that approximately 75% of all views for this feature program will occur in the first month of the license term. DVC will amortize $3.75 million (75% of $5 million) in the first month and the remaining asset value will be amortized evenly over the remaining 23 months of the license term, as this reflects DVC's expected views based on its history with similar titles.



3a How do windows of availability affect the amortization pattern?

Certain license arrangements may also include specific periods (i.e., windows) in which the licensee may exploit the licensed content. For example, a three-year arrangement for a license of a feature program may include the rights to air the feature program only in years one and three. In these cases, the licensee will allocate the fee to the two license periods (i.e., years one and three) based on their relative fair value. Based on the values allocated to each license period, the licensee will record amortization in year one but will not record any amortization during the second year because it does not receive any benefit from the content. Noteworthy is that whether the arrangement is viewed as one license (a three-year license for a feature program that can only be broadcast in year one and year three) or two separate one-year licenses, the method of amortization will not change.

3b How should a licensee account for an arrangement that includes geographies or platforms where the license period begins before the expected exploitation period?

Certain license arrangements may include rights that will not be exploited at the beginning of the license period. For example, a licensee may have the rights to a title in multiple countries but may not plan to launch the service (i.e., broadcast the content) in a particular market until a later date within the license period. In this case, the licensee would record amortization based on the market's relative fair value and would not begin to record amortization until the later of the license period or the launch date. The amortization method would be determined considering the factors discussed on the previous page.

3c What are some of the impairment considerations for entities that license digital content?

Capitalized content costs are to be assessed for impairment if projections of the expected benefit (program usefulness) are revised downward. Capitalized content costs that are impaired should be stated at the lower of unamortized cost or net realizable value (NRV). In accordance with the guidance in ASC 920, broadcasters test licensed content for impairment if a program is not expected to be monetized as projected or if the planned use for a title changes.

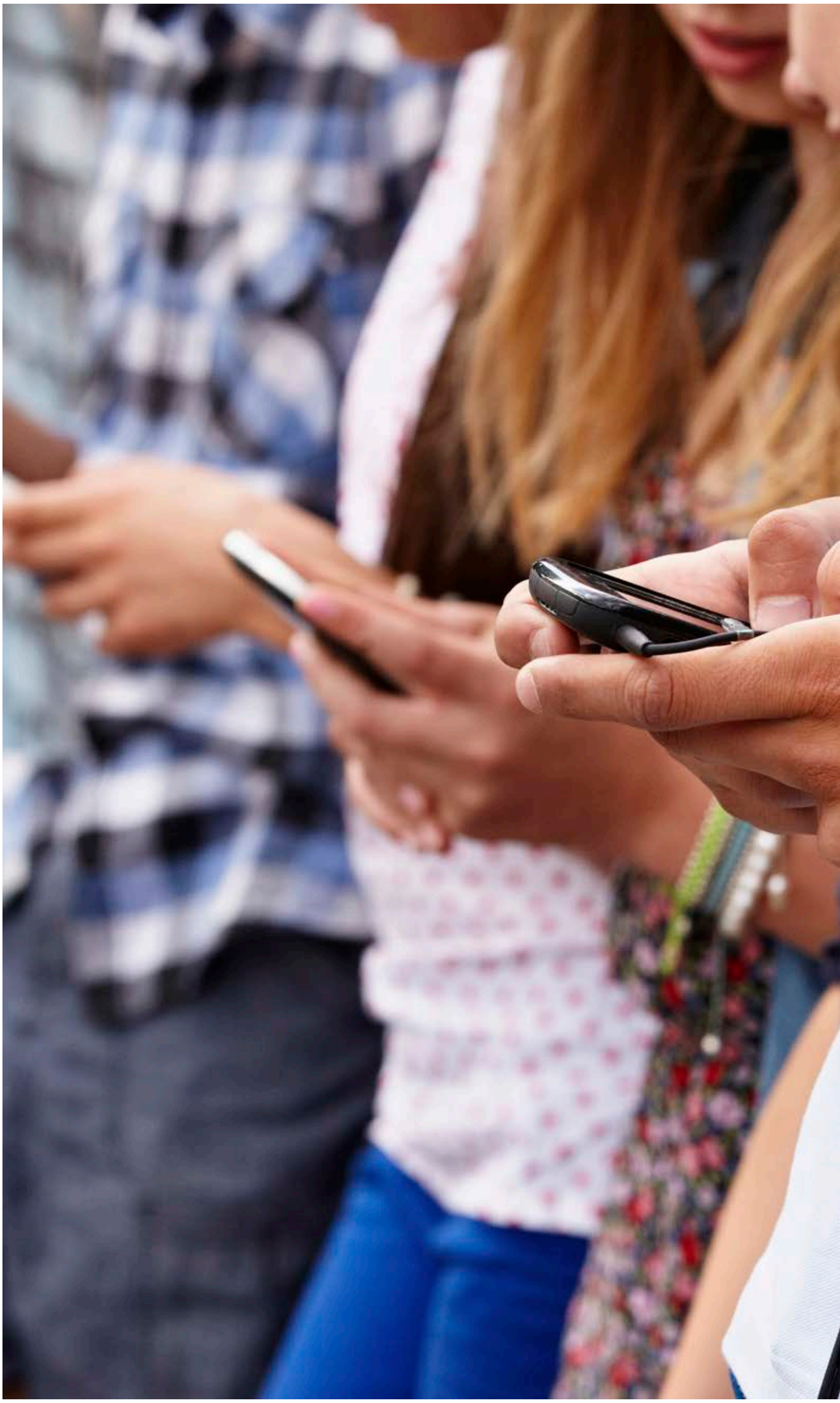
The guidance in ASC 920 allows for licensed content to be aggregated under various methods in order to assess it for impairment. Content may be aggregated by program, daypart, series or package. A daypart could be an aggregation of programs broadcast during a particular time of day (e.g., daytime, evening, late night) or programs of a similar type/genre/channel (e.g., sports, news, children's shows, an overall cable channel). Typically, content is aggregated for purposes of the NRV test based on how the content is monetized, that is, the lowest level of identifiable cash flows. For example, if advertising is sold by daypart on a specific channel, this may be the appropriate aggregation method for the NRV test.

If the content is monetized through a subscription fee for access in a particular geography, it may be appropriate for the content to be aggregated on an overall basis for the entire library of content (akin to traditional cable channels with similar programs for the overall channel).

If a licensee decides to stop using or abandons a particular title (e.g., a specific film or television show) before the end of the license period, the remaining unamortized cost for that title should be written off to the amount that is recoverable, which most likely will be zero unless the licensee has rights to further monetize.

3d Should a license for an extended period of time be accounted for under ASC 920?

Licenses for an extended period of time typically include older titles or a library of titles. Such licenses are accounted for under ASC 920. While a licensee has access to content for an extended period of time, typically such licenses are amortized over a shorter defined period (e.g., a 10-to-20-year period that factors in industry experience or the experience of the licensee with similar titles) if it is determined the expected benefit from the content is *de minimis* later in the license term.



Accounting considerations for the production of content for self-distribution

1 *Should entities that produce content to be distributed on their own digital services apply ASC 926?*

While ASC 926 has traditionally been applied by film and episodic television producers, questions have arisen as to whether entities that produce programs for distribution on their streaming and online services should apply this guidance. ASC 926 applies to "all entities that are producers[5] or distributors[6] that own or hold rights to distribute or exploit all kinds of films[7] in one or more markets and territories."

ASC 926 also notes that it "applies to films exploited by the entity directly, or licensed or sold to others." The definition of a producer as "an entity that produces and has a financial interest in films for exhibition in movie theaters, on television, or elsewhere" would include an entity that produces a film or series that is exhibited on a streaming or other online service, thus subjecting those activities to ASC 926.

2 *How are costs incurred for production of content accounted for by entities that produce their own digital content under ASC 926?*

The types of costs associated with developing and producing digital content for distribution that are typically capitalizable include the (1) rights to screenplays, (2) salaries for actors, directors and other personnel and (3) production and post-production costs. The costs of acquiring a film's copyright rather than licensing the content would be capitalizable under ASC 926.

When assessing whether costs related to production of digital content are capitalizable, a producer should assess whether the costs relate directly to the production of the digital content.

When considering participations[8] and residuals[9] for a title, it is important to understand whether the terms of the arrangements differ for digital content and more traditional content. For example, while residuals traditionally are calculated based on a percentage of gross revenues from ancillary markets, they may be based on another measure for digital content.

For production of episodic television, ASC 926 requires that capitalized costs for each episode produced not exceed the amount of revenue contracted for that episode until a secondary market can be established.

All costs on an episode-by-episode basis incurred in excess of the contracted revenue amount should be expensed until a secondary market is established.

All costs capitalized related to the development of content under ASC 926, whether for the production of films or episodic television, are referred to as "film costs" in the guidance and the remainder of this publication.

2a How are costs incurred for production of an app to deliver content accounted for by entities that produce their own app?

Costs incurred for building a digital service app or a direct-to-consumer app for a specific film may not be capitalizable under ASC 926 but may be capitalized under other accounting guidance (e.g., internally developed software), if appropriate.

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5 A producer is defined in ASC 926 as "an individual or an entity that produces and has a financial interest in films for exhibition in movie theaters, on television, or elsewhere."

6 A distributor is defined in ASC 926 as "an entity or individual that owns or holds the rights to distribute films. The definition of distributor of a film does not include, for example, those entities that function solely as broadcasters, retail outlets (such as video stores), or movie theaters."

7 Films is defined in ASC 926 as "feature films, television specials, television series, or similar products (including animated films and television programming) that are sold, licensed, or exhibited, whether produced on film, video tape, digital, or other video recording format."

8 A participation is contingent compensation paid to the creative talent (e.g., actors, writers, directors and producers) that is based on a formula described in the contract.

9 Residuals are paid to various guild members who work on the production of content as additional compensation for use of the content in ancillary markets, such as home video, pay television and cable, network television and digital services.

3 What is the individual-film-forecast model in ASC 926?

Capitalized film costs are amortized using the individual-film-forecast-computation method under ASC 926. Under this method and in the absence of changes in estimates, an entity amortizes capitalized film costs in a manner that yields a constant rate of profit over the ultimate period, which considers a film's actual current-period revenue and estimated remaining "ultimate revenue." Ultimate revenue is an estimate of all revenues expected to be received from the exploitation, exhibition and sale of a film in all markets and territories (e.g., theatrical, home video, television, digital services, DVDs/Blu-ray and direct advertising).

The following is the basic calculation to amortize capitalized film costs (e.g., starting in year one for a film). For episodic television, capitalized costs are typically amortized over the contracted season until a secondary market is established. At that time, this calculation is as follows:

Year 1 amortization

$$\frac{\text{Year 1 revenues}}{\text{Ultimate revenues}} \times \text{Ultimate costs}$$

Year 2 amortization

$$\frac{\text{Year 2 revenues}}{\text{Ultimate revenues remaining as of the beginning of the current fiscal year}} \times \text{Ultimate costs remaining as of the beginning of the current fiscal year}$$

Ultimate costs are an estimate of all capitalizable film costs to be incurred related to the production of the film.

4 What are some of the considerations for a producer of digital content when applying the individual-film-forecast model under ASC 926 to amortize capitalized film costs?

For producers of digitally distributed content, applying this guidance has been challenging because the primary sources of ultimate revenues are from non-traditional distribution channels. ASC 926 notes that: "In the absence of revenue from third parties that is directly related to the exhibition or exploitation of a film, an entity shall make a reasonably reliable estimate of the portion of unamortized film costs that is representative of the use of the film in that exhibition or exploitation. An entity shall expense such amounts as it exhibits or exploits the film. (For example, a cable entity that does not accept advertising on its cable channel may produce a film and show it on that channel. In this example, the cable entity receives subscription fees from third parties that are not directly related to a particular film.) Consistent with the underlying premise of the individual-film-forecast-computation method, all revenue shall bear a representative amount of the amortization of film costs during the ultimate period."

5 *What are some of the considerations for a producer when assessing digital content for impairment under ASC 926?*

Unamortized costs are to be assessed for impairment, regardless of whether the produced content (e.g., film or television series) is completed. Producers of content should perform a review whenever events or changes in circumstances indicate that the fair value of the produced content may be less than its unamortized costs. Additionally, ASU 2012-07 eliminated the rebuttable presumption in ASC 926 that conditions existing after the balance sheet date, but before the financial statements are issued, were presumed to have existed at the balance sheet date.

Examples of indicators of impairment include:

- An adverse change in the expected performance of the content prior to release
- Actual costs substantially in excess of budgeted costs
- Substantial delays in completion or release schedules
- Changes in release plans, such as a reduction in the initial release pattern
- Insufficient funding or resources to complete production of the content and to market it effectively
- Actual performance after release failing to meet expectations

Other indicators of impairment for digital content may be changes in usage or changes in certain metrics used by management, such as cost per program hour.

If an entity determines the fair value of produced content using a traditional discounted cash flow approach, the discount rate should consider the expectations about possible variations in the amount or timing of the most likely cash inflows and outflows. If an entity uses an expected cash flow approach, the future cash inflows and outflows are probability weighted by period to address the uncertainty in cash flows.

Digital content presentation and disclosure

1 *Are there any presentation and disclosure considerations producers of digital content should take into account?*

Balance sheet

There is diversity in practice in the financial statement line item used for capitalized costs related to licensed and owned content. The guidance in ASC 920 and ASC 926 does not specify the caption, and reasonable captions include captions that are commensurate with the related revenue streams, such as film costs, filmed entertainment and television costs, licensed program rights, programming and other inventory, content library (or rights) and broadcast rights.

For licensed content costs that are capitalized, ASC 920 states the asset recorded is segregated between current and noncurrent on the balance sheet, based on the estimated time of usage. The related liability is also segregated between current and non-current on the balance sheet based on the payment terms.

For film costs that are capitalized, ASC 926 states that if an entity presents a classified balance sheet, the film costs' asset is classified as non-current on the balance sheet.

Statement of cash flows

ASC 926 includes guidance that cash outflows for film costs, participation costs and exploitation costs should be classified within operating activities in the statement of cash flows. While ASC 920 does not include specific guidance for licensees of content on how to classify activities in the statement of cash flows, many large, traditional broadcasters present cash outflows related to the license of content as operating activities.

Commitments and contingencies

Item 303(a)(5) of Regulation S-K requires Securities & Exchange Commission (SEC) registrants to provide a tabular presentation of known contractual obligations as of the end of the most recent fiscal year. SEC Financial Release No. 83, "Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis (FR-83)," notes that the goal of the contractual obligations table is to present a meaningful snapshot of cash requirements arising from contractual payment obligations. Further, under ASC 920, "broadcasters shall disclose commitments for license agreements that have been executed but were not reported because they do not meet the conditions for recording a liability." Thus, content producers and licensees of content disclose commitments for future amounts owed (i.e., purchase obligations) under various agreements, including licensing and programming arrangements, as well as production costs such as talent and employment agreements. For certain arrangements, determining when to report the commitment may require judgment. The determination of whether an entity has entered into such a commitment will depend upon the terms of the agreement (e.g., when production has begun, when the content has been aired on a network, when there are a minimum number of episodes to be licensed).

Exhibit: Key differences between ASC 920 and ASC 926

	ASC 920	ASC 926
Cost capitalization	The fee paid for licensed content is capitalized when the license period begins and all of the following conditions have been met: ▸ The cost of each program is known or reasonably determinable. ▸ The program material has been accepted by the licensee. ▸ The program material is available for its first showing.	Costs related directly to the production of content are capitalized as film costs as they are incurred. ASC 926 limits the capitalization of costs for each episode of a television series produced to the amount of revenue contracted for that episode until a secondary market can be established.
Amortization methods	Capitalized costs are amortized using any of the following, as appropriate: ▸ Straight-line ▸ Accelerated Feature programs should be amortized on a program-by-program basis; however, amortization as a package may be appropriate if it approximates the amortization that would have been provided on a program-by-program basis. Program series should be amortized as a series.	Capitalized film costs are amortized under the individual-film-forecast-computation method in a manner that yields a constant rate of profit over the ultimate period, assuming there are no changes in estimates. This considers a film's actual current-period revenue and estimated remaining "ultimate revenue." In the absence of revenue from third parties that is directly related to the exhibition or exploitation of a film, an entity should make a reasonably reliable estimate of the portion of unamortized film costs that is representative of the use of the film in that exhibition or exploitation. An entity must expense such amounts as it exhibits or exploits the film.
Impairment testing methods	The entity assesses whether capitalized content costs are impaired and states these costs at the lower of unamortized cost or NRV. Licensed content may be aggregated by program, daypart, series or package in order to assess it for impairment.	The entity assesses whether the fair value of the produced content is less than its unamortized cost. Fair value is typically determined using a traditional discounted cash flow approach or other applicable method.

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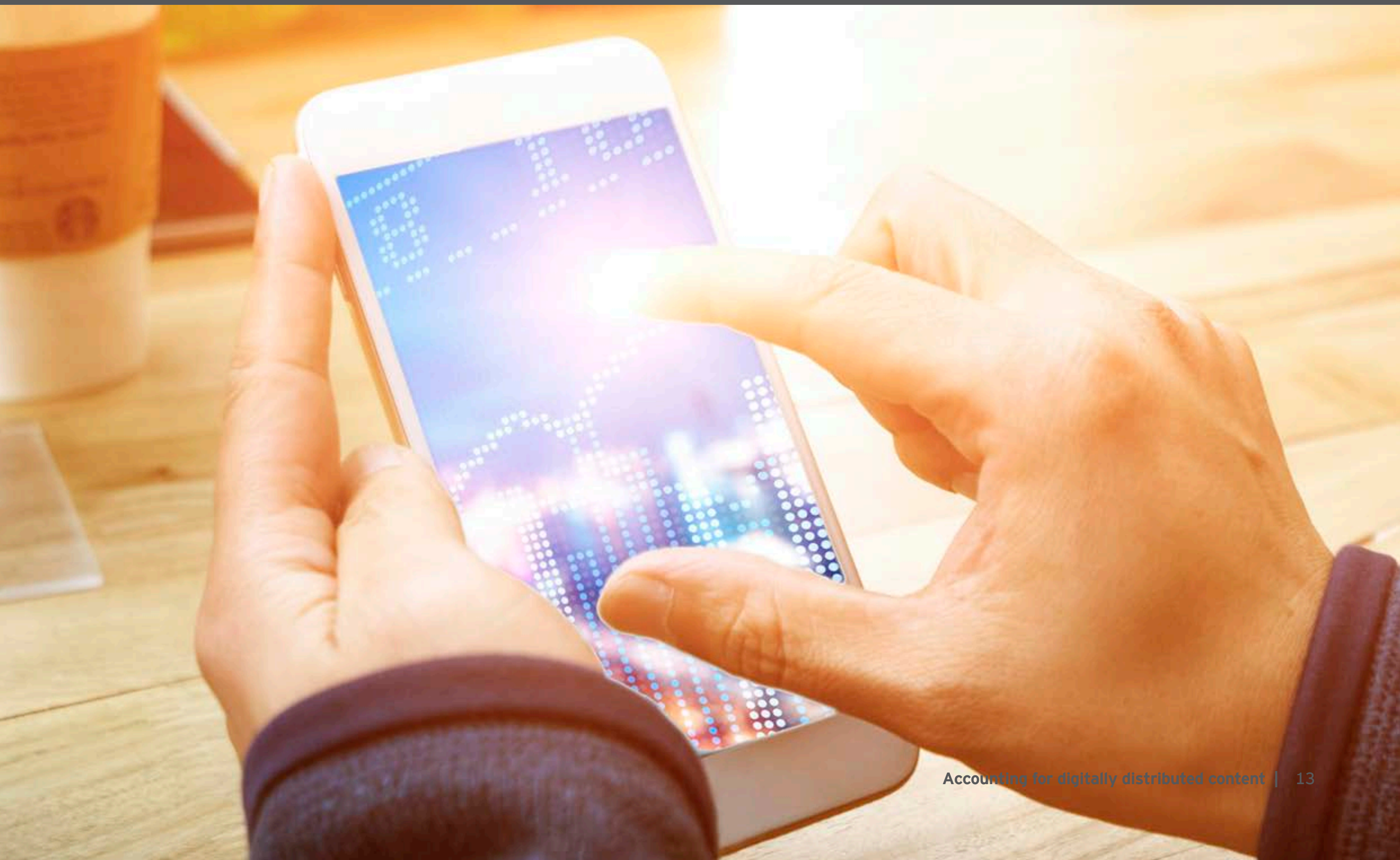

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