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Technical Line

The new revenue recognition standard — media and entertainment

In this issue:

What you need to know

- The new standard will replace today's industry-specific media and entertainment (M&E) guidance with principles-based guidance that will require more judgment to apply.
- M&E entities that license intellectual property (IP) will need to determine whether a license provides a right transferred to a customer at a point in time or a promise to provide access over time. This evaluation will dictate the timing of revenue recognition.
- All M&E entities will need to assess how they will be affected by the new standard, including changes to the guidance for advertising barter transactions and cost capitalization.
- The new standard is effective for public entities[1] for fiscal years beginning after 15 December 2016 and for interim periods therein. It is effective for nonpublic entities for fiscal years beginning after 15 December 2017 and interim periods within fiscal years beginning after 15 December 2018.

Overview

M&E entities may need to change certain revenue recognition practices as a result of the new revenue recognition standard jointly issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards). The new revenue recognition standard will supersede virtually all revenue recognition guidance in US GAAP and IFRS, including industry-specific guidance that M&E entities use today. See the Appendix for further detail of the M&E industry-specific US GAAP guidance that is superseded.

Building a better working world

The new standard provides the accounting for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless those contracts are in the scope of other US GAAP requirements, such as the leasing literature). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of nonfinancial assets to customers or noncustomers, such as property and equipment, including real estate. The following M&E subsectors are expected to be affected:

- Advertising and measurement
- Broadcasting and cable networks
- Film, TV, online video, and electronic games production and distribution
- Media conglomerates
- Music
- Publishing and information services
- Sports, theme parks and live events
- Cable and satellite distributors (multichannel video programming distributors)

We believe views about the appropriate application of the guidance to specific fact patterns in the M&E industry may evolve over time.

The new standard may affect companies within each subsector differently. However, all entities in these subsectors will have to carefully consider the implications of the standard. M&E entities will have to make more estimates and use more judgment than they do under today's guidance.

M&E entities also may want to monitor the discussions of the Boards' Joint Transition Resource Group for Revenue Recognition (TRG). The Boards created the TRG to help them determine whether more implementation guidance or education is needed. The TRG won't make formal recommendations to the Boards or issue guidance. Separately, the American Institute of Certified Public Accountants (AICPA) has established 16 industry task forces to help develop a new Accounting Guide on Revenue Recognition and to aid industry stakeholders in implementing the standard. The AICPA has not established a task force for the M&E industry. Any views discussed by the TRG or guidance produced by the AICPA is non-authoritative.

This publication considers key implications of the revenue recognition standard for M&E entities. This publication first discusses the recognition of revenue for licenses of IP, which differs slightly from the overall model for other promised goods and services. It then highlights key considerations for the M&E industry related to other aspects of the new revenue recognition model, whose core principle is that an entity will recognize revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods and services to a customer. This publication supplements our Technical Line, *A closer look at the new revenue recognition standard* (SCORE No. BB2771), and should be read in conjunction with it.

The views we express in this publication are preliminary. We may identify additional issues as we analyze the standard and entities begin to interpret it, and our views may evolve during that process. As our understanding of the standard evolves, we will issue updated guidance.

Licenses

License arrangements of IP are common in the M&E industry and include, for example, a motion picture studio granting rights to broadcast a film or television program, a motion picture studio granting distribution rights associated with a film, a music company granting its music library content to a digital publisher, a book publisher licensing the international rights to a character, and a sports league granting the right to use a sports team's name and logo.

The standard provides guidance for accounting for licenses of IP that differs slightly from the overall model for other promised goods and services. This guidance will require M&E entities to analyze the facts and circumstances of each contract, and we believe this may lead to different judgments and in some instances interpretive questions. We have highlighted three key accounting considerations for arrangements involving licenses and illustrated their effects below:

- Determining whether a license is distinct
- Determining the nature of the entity's promise
- Accounting for a contract with a license for IP and sales- or usage-based royalty

Because the accounting for M&E licenses will require thorough analysis of all facts and circumstances, these examples are not intended to address all situations.

M&E entities will have to exercise significant judgment in assessing whether a license provides a right to access IP or a right to use IP at a point in time.

Determining whether a license is distinct

The guidance on the timing of revenue recognition (point in time or over time) for licenses of IP applies only to licenses that an entity determines are distinct. A license is distinct if the customer can benefit from the license on its own or the license can be used with other readily available resources, and it is separately identifiable from the other goods or services in the arrangement. For licenses that are not distinct, an entity will follow the guidance in the overall model to account for the performance obligation that contains a license and at least one other good or service.

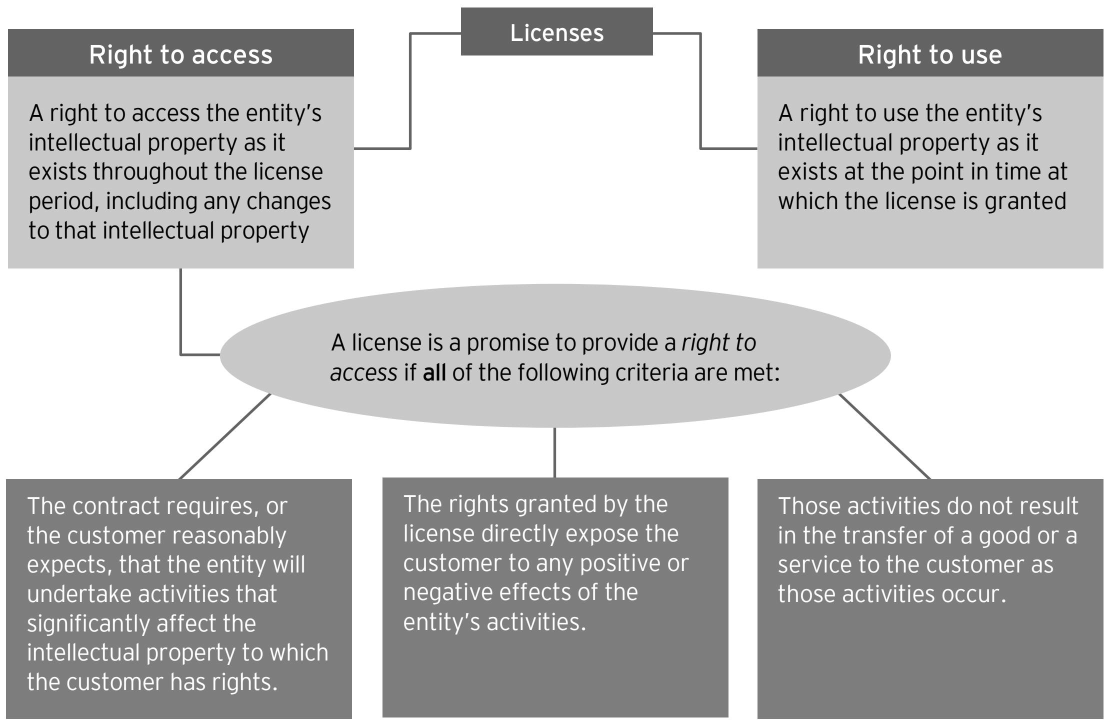
Licenses of IP are frequently included in multiple-element arrangements, and promises for additional goods and services may be explicit or implicit. For example, an arrangement may include a distribution license for a film and the related marketing by the licensor during the license period. In order to apply the guidance for licenses of IP in this case, an entity must conclude that the license is distinct – that is, that the customer can benefit from the distribution license on its own or together with readily available resources and that the distribution license is separately identifiable from the related marketing services.

If an M&E entity provides a customer with the license to a song/film/television show but only in conjunction with a hosting service, the customer cannot use the IP without the hosting. In this example, the customer may not be able to benefit from the license on its own or from other readily available resources. That is, the license may not be distinct and may be combined with those other promised goods or services. The guidance on licenses of IP would not apply.

When assessing licensing arrangements, M&E entities will have to exercise significant judgment to identify performance obligations and assess whether a license of IP is distinct. The facts and circumstances of each arrangement will have to be carefully considered.

Determining the nature of the entity's promise

For all licenses of IP determined to be distinct, an entity must then determine whether the license provides the customer with a right to use the IP as it exists at the point in time at which the license is granted or a right to access the IP as it exists throughout the license period by considering the nature of the promise to the customer. The standard states that entities provide their customers with either:



The standard does not specify the types of activities that would significantly affect the IP and would trigger treatment as a right to access a license of IP. The standard says a customer cannot direct the use of, and obtain substantially all of the remaining benefits from, a license at the point in time at which the license is granted if the IP to which the customer has rights changes throughout the license period. The IP will change (and thus affect the entity's assessment of when the customer controls the license) when the entity continues to be involved with its IP and the entity undertakes activities that significantly affect the IP to which the customer has rights. Careful consideration will need to be given to assess what types of changes could occur to the IP.

If the license does not meet all three criteria in the graphic above, the license agreement provides a *right to use* the IP, and the entity would recognize revenue at the point in time when the control of the license transfers to the licensee.

The existence of a shared economic interest between the parties (e.g., sales- or usage-based royalties) may be an indicator that the customer has a reasonable expectation that the entity will undertake activities that will significantly affect the IP. The standard also notes that an entity should disregard the following when assessing whether a license provides *access* or a *right to use* IP:

- Restrictions of time, geographical region or use (e.g., number of airings)
- Guarantees provided by the entity that it has a valid patent to IP and that it will defend that patent from unauthorized use

The following table provides examples of licenses and certain considerations for assessing the criteria to determine whether a license provides a *right to access* or a *right to use* the IP. Since the standard may be interpreted in different ways and views continue to evolve, ***the examples below discuss different points of view and are not conclusive*** (except for the example that the Boards included in the standard). In addition, it is unknown whether the different views on licenses will be discussed by the TRG and whether the Boards will consider any further guidance or clarification of the applicable principles.

Possible views of licenses of IP

	A sports team (licensor) licenses its logo to an apparel manufacturer (licensee) for printing on hats and t-shirts *[Example 61 in the standard]*	A TV studio (licensor) licenses a syndicated season of a TV show	A film studio (licensor) produced a film in 2010 and is now licensing the film internationally
Access to IP (View A)			
What is the underlying IP	The sports team's name and logo	The syndicated season	The film
The contract requires (or the customer reasonably expects) that the entity will undertake activities that significantly affect the intellectual property (606-10-55-60a)	Examples of certain activities: ▶ Playing games ▶ Providing a competitive team	Examples of certain activities: ▶ Licensing of IP to other licensees (e.g., broadcasters) ▶ Production of additional seasons ▶ Release of series on DVD/ new media/on a new platform ▶ Creation of another series that affects the licensor's brand (e.g., a spin-off) ▶ Promotional activities for the show (e.g., brand), including creating ancillary content	Examples of certain activities: ▶ Release of film on new media/on a new platform ▶ Creating and marketing consumer products (e.g., theme park attractions and other promotional activities) ▶ Creating a sequel (i.e., continuation of IP) ▶ Creating a different film with a related storyline or characters (i.e., affects the licensor's brand)
	Shared economic interest:		
	Since the licensor's earnings depend on the success of the licensee's sales (through the sales-based royalty), the licensor and licensee have a shared economic interest. Thus, the licensee may expect the licensor to undertake certain activities (e.g., continuing to play, providing a competitive team) to maximize earnings.	If the licensor and licensee have a shared economic interest in the success or failure of the underlying IP, this may indicate that the licensee could reasonably expect the licensor to undertake these activities.	
The rights granted by the license directly expose the customer to any positive or negative effects (606-10-55-60b)	Examples of positive or negative effects: ▶ The rights to use the team name and logo directly expose the licensee to the effects of the team playing games and being competitive.	Examples of positive or negative effects: ▶ The right to use the IP for the syndicated season directly exposes the licensee to the effects of the licensor's efforts to create continued/ heightened awareness of the show (e.g., brand), which could result in attracting viewers to watch the airing of the syndicated season on the licensee's network.	Examples of positive or negative effects: ▶ The right to use the IP internationally directly exposes the licensee to the effects of the licensor's efforts to create continued/ heightened awareness of the film, which could result in attracting more viewers to purchase the film on available media.

Those activities do not result in the transfer of a good or a service to the customer *(606-10-55-60c)*	The activities performed by the licensor do not result in the transfer of goods or services.		
Right to use IP (View B)			
What is the underlying IP	The sports team's name and logo	The syndicated season	The film
Does the customer have a right to use the IP as it exists in terms of form and functionality at the point in time when the license is granted? *(606-10-55-63)*	No, the licensee will be using the most recent form of the IP throughout the license period. For example, if the team's logo changes, that new form of the IP will be used by the licensee for the remainder of the period.	Yes, the licensee has the right to use the IP that exists when the license is granted. The licensor's activities will not significantly affect the IP because: ▸ The underlying IP of the TV show's season will not change (e.g., shows produced and taped). ▸ Changes to the characters or to the TV show such as rights to future seasons will not affect the current license agreement. The licensee typically does not have access or rights to the most recent form of the additional IP that will be developed in the future, and those future seasons may be part of a separate arrangement. ▸ Other promotional activities that may promote the "brand" of the show may be separate performance obligations from the licensed IP. In addition, the promotional activities may affect the value of other distribution channels for the licensor (i.e., new licenses), but they do not significantly affect the underlying IP to which the licensee has rights. Activities described above for access to IP are primarily for the benefit of the licensor and are not anticipated by the licensee (e.g., are not contractual obligations to the licensee).	Yes, the licensee has the right to use the IP that exists when the license is granted. The licensor's activities will not significantly affect the IP because: ▸ The underlying IP of the film will not change (e.g., film is produced and recorded). ▸ If a sequel is not created then a more recent form of the IP does not exist. ▸ If a sequel is produced, this will not affect the current license agreement but will be part of a separate license arrangement. The licensee typically does not have access or rights to the most recent form of that additional IP that will be developed in the future, and sequel rights will be part of a separate arrangement. ▸ Other promotional activities that may promote the "brand" of the film may be separate performance obligations from the licensed IP. Activities described above for access to IP are primarily for the benefit of the licensor and are not anticipated by the licensee (e.g., are not contractual obligations to the licensee).
Conclusion	The Boards concluded this is a license to access the IP	To be assessed on a transactional basis	To be assessed on a transactional basis

How we see it

It is unclear what types of activities and to what extent such activities would be considered to significantly affect the IP such that the customer is directly exposed to the positive and negative effects of those activities. M&E entities will have to exercise significant judgment in assessing whether the extent of the activities undertaken have significantly affected the IP and whether the IP, to which the customer has rights, changes throughout the license period. In light of the number of questions regarding licenses, it is possible that the Boards may provide more interpretive guidance in this area.

License arrangements that include sales- or usage-based royalties

M&E entities commonly enter into arrangements that require the customer to pay a sales- or usage-based royalty in exchange for the license of IP. For example, a licensee may be required to pay a percentage of the sales price of items using a sport team's name or logo or a fixed amount based on the number of plays of a movie.

The standard provides explicit guidance for recognizing sales- and usage-based royalties from licenses of IP that creates an exception to the requirements to estimate variable consideration (the sales-based royalty exception). As a result, these amounts are recognized only when 1) the sale or usage occurs or 2) the performance obligation to which some or all of the sales- or usage-based royalty has been allocated is satisfied (in whole or in part), whichever occurs later.

The standard provides specific guidance on sales- or usage-based royalties on licenses of IP.

This sales-based royalty exception is similar to existing practice, and as a result, the accounting for many M&E sales- and usage-based royalty arrangements may not change. For example, film studios will continue to recognize revenue for the license of a newly released film (for which consideration for the film license is a sales-based royalty) when actual tickets are sold.

Licenses of IP versus sale of related tangible good

It is important to note that the sales-based royalty exception applies only to licenses of IP and not to sales of tangible goods that include a significant amount of IP.

For example, access to educational software online is provided through a license of IP. However, the purchase of a physical book (which contains similar content to the online educational software) with a sales-based royalty is not considered a license of IP, and the sales-based royalty exception would not apply.

Another example is if a book publisher sells physical books to a bookstore in exchange for a percentage of the bookstore's sales price when the books are sold to its customers. In this example, the publisher would follow the guidance on variable consideration. That is, the publisher would estimate the future royalties and recognize those amounts as revenue when control of the books transfers to the bookstore (and before the bookstore sells the books to its customers) as long as any subsequent changes in the estimated royalties would not result in a significant revenue reversal.

Arrangements including licenses of IP and other goods or services

It is unclear whether this sales-based royalty exception will apply to royalties that relate to both licensed IP and other goods or services in a single arrangement. These arrangements could involve a contract with two performance obligations such as a distinct license to access a textbook online and separate tangible study materials that would be provided in the future and would affect the amount of royalties earned. They also could involve licensed IP that is accounted for together with other goods or services (e.g., a contract with a license to distribute a film and a promise by the licensor to provide advertising for the film in the customer's distribution area that may require the arrangement to be bundled into one performance obligation). The TRG recently discussed two primary views on how to apply the sales-based royalty exception:

- View A: Apply the sales-based royalty exception whenever the royalty relates to a license, regardless of whether it also relates to a non-license good or service or whether the license is a separate performance obligation
- View B: Apply the sales-based royalty exception only when the royalty relates solely to a license and that license is a separate performance obligation

TRG members did not express a consistent view, and the Boards have said they will provide a status update on this issue on or before the next TRG meeting on 31 October 2014. The Boards could decide to further consider the issue.

Summary of other key aspects of the new model

We will now highlight key considerations for the M&E industry related to other aspects of the new revenue recognition model.

The new guidance outlines the principles an entity must apply to measure and recognize revenue and the related cash flows. The core principle is that an entity will recognize revenue at an amount that reflects the consideration the entity expects to be entitled to in exchange for transferring goods or services to a customer.

The principles in the new standard will be applied using the following five steps:

1. Identify the contract(s) with the customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies each performance obligation

An entity will need to exercise judgment when considering the terms of the contract(s) and all of the facts and circumstances, including implied contract terms. An entity also will have to apply the requirements of the new standard consistently to contracts with similar characteristics and in similar circumstances. On both an interim and annual basis, an entity generally will have to provide more disclosures than it does today and include qualitative and quantitative information about its contracts with customers, significant judgments made (and changes in those judgments) and contract assets from costs to obtain or fulfill a contract. On an interim basis, US GAAP will require more disclosure than will be required under IFRS.

Scope, transition and effective date

The scope of the new revenue recognition guidance includes all contracts with customers to provide goods or services in the ordinary course of business, except for contracts that are specifically excluded from the scope (e.g., leases, insurance contracts, financial instruments, guarantees).

The new standard is effective for public entities[1] for fiscal years beginning after 15 December 2016 and for interim periods therein. It is effective for nonpublic entities for fiscal years beginning after 15 December 2017 and interim periods within fiscal years beginning after 15 December 2018, and they may elect to adopt the guidance as early as the public entity effective date. Under US GAAP, early adoption is prohibited for public entities.

All entities will be required to apply the standard retrospectively, either using a "full retrospective" or a "modified retrospective" approach. The Boards provided certain practical expedients to make it easier for entities to use a full retrospective approach.

Under the modified retrospective approach, financial statements will be prepared for the year of adoption using the new standard, but prior periods won't be adjusted. Instead, an entity will recognize a cumulative catch-up adjustment to the opening balance of retained earnings (or other appropriate component of equity or net assets) at the date of initial application for contracts that still require performance by the entity (i.e., contracts that are not completed). Entities will need to provide certain disclosures in the year of adoption, such as the amount by which each financial statement line item is affected as a result of applying the new standard.

For more information about the effective date and transition options, see our Technical Line, *A closer look at the new revenue recognition standard* (SCORE No. BB2771).

Identify the contract(s) with the customer

The model applies to all contracts with customers. Contracts may be written, oral or implied by an entity's customary business practice but must be enforceable by law and meet specified criteria. An entity must combine two or more contracts that it enters into at or near the same time with the same customer (or related parties of the customer) and account for them as a single contract, if they meet specified criteria.

An assessment of collectibility is included as one of the criteria for determining whether a contract with a customer exists. That is, an entity must conclude it is probable that it will collect the consideration to which it will be entitled. The amount of consideration to which an entity expects to be entitled (i.e., the transaction price) may differ from the stated contract price (e.g., if the entity intends to offer a concession and accept an amount less than the contractual amount). When performing the collectibility assessment, an entity should consider only the customer's ability and intention to pay the expected consideration when due.

How we see it

Considering oral or implied agreements may be a significant change in practice for some M&E entities, such as advertisers or cable networks. Under today's guidance, one of the criteria for recognizing revenue is that persuasive evidence of an arrangement must exist. This generally means a fully executed contract or some other evidence to document the arrangement. Under the new standard, oral or implied agreements that create enforceable actions may exist prior to a final executed contract, which may result in an M&E entity accounting for an arrangement earlier.

M&E entities also should keep in mind the fact that the determination of whether an arrangement has created rights or obligations is a question of law, and the factors that determine enforceability may differ by jurisdiction (e.g., multi-national considerations).

Contract modifications

A contract modification is a change in the scope or price (or both) of a contract. Changes to M&E contracts occur frequently. For example, cable or satellite subscribers may change their cable plans, a producer may increase the license price of a popular TV show or advertisers may change the number and/or timing of advertising placements. An entity must determine whether the modification should be accounted for as a separate contract or as part of the original contract.

Both of the following criteria must be met for a modification to be treated as a new and separate contract:

- The additional goods or services are distinct from the goods or services in the original contract.
- The amount of consideration expected for the added items reflects the standalone selling price of those items.

Illustration 1 — Contract modification that is a separate contract

Film Studio A licenses the first season of a television show to a broadcaster for a fixed fee of $10 million. The agreement does not discuss options for licensing future seasons. While the broadcaster is airing the first season, Film Studio A and the broadcaster agree to modify the current license agreement to include the license of the second season for an additional license fee of $12 million, reflecting a price increase for the second season due to the popularity of the first season and the positive ratings performance. The price for the second season is determined to be the standalone selling price based on the popularity of the television show and the positive ratings performance. Film Studio A has determined that the second season of the television show is distinct from the first season because each season can be aired on its own or together with season one and each season is separately identifiable in the contract.

The film studio assesses the contract modification criteria as follows:

- The second season of the television show was determined to be distinct from the first season.
- The price for the second season is the standalone selling price.

Therefore, the film studio concluded that the contract modification is a separate contract and will account for it as such.

Entities will have to carefully consider whether there is more than one performance obligation.

Contract modifications that do not meet the criteria to be treated as separate contracts are considered changes to the original contract. These modifications are accounted for either on a prospective basis or a cumulative catch-up basis, depending on whether the goods and services being modified are distinct from the other goods and services provided within the arrangement.

Identify the performance obligations in the contract

An entity will then evaluate the contract terms and its customary business practices to identify all promised goods or services within the contract and determine which of those promised goods or services (or bundle of promised goods or services) should be accounted for as separate performance obligations.

Promised goods and services represent separate performance obligations if the goods or services are distinct (by themselves or as part of a bundle of goods and services) or if the goods and services are part of a series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer. A good or service (or bundle of goods and services) is distinct if the customer can benefit from the good or service on its own or together with other readily available resources (i.e., the good or service is capable of being distinct) and the good or service is separately identifiable from other promises in the contract (i.e., the good or service is distinct within the context of the contract).

For example, a publisher may offer a one-year subscription for a physical newspaper only, a digital copy only or a bundled package of both the physical paper and the digital paper. Both the physical newspaper and digital copy are distinct. A customer can benefit from the physical newspaper on its own and from the digital copy through use of a mobile device or computer, and both goods are separately identifiable, on their own and within the context of the contract. Therefore, the digital and physical subscriptions are separate performance obligations.

M&E entities frequently offer free products and services as an inducement for customers to enter into contracts (e.g., free advertisements that are bundled with paid advertisements). Although an entity might consider these goods or services to be marketing incentives or incidental goods or services, the Boards concluded that they are goods or services for which the customer pays and that the entity should evaluate them under the revenue model (i.e., determine whether they are distinct goods or services to which consideration would be allocated for purposes of revenue recognition).

M&E entities may enter into an arrangement that includes the delivery of existing content as well as new content. For example, a music producer may license its existing music library to a digital publisher for a specified period. The arrangement may also provide the digital publisher with the license to new songs as they are released during the specified period for no additional fee. Careful consideration of the facts and circumstances is required to determine whether the existing music library and the new songs are one or multiple performance obligations. For instance, if the customer can benefit from the existing library on its own (without the new songs) and the existing library is separately identifiable from the new songs, the existing library would be a separate performance obligation. In this case, further evaluation would be needed to determine whether each new song that is released is a separate performance obligation.

Properly identifying performance obligations within a contract is a critical component of the new revenue model.

Certain license arrangements also may include specific periods (i.e., windows) in which the licensee may or may not exploit the licensed content. For example, an M&E entity may license the international rights to a character in the first and third year of a contract for a fixed fee. An M&E entity should consider the facts and circumstances of the arrangement to determine whether each window is distinct and therefore should be accounted for as a separate performance obligation. As noted above in the licenses section, the standard states that restrictions of time, geographical region or use should be disregarded when assessing whether a license provides access or a right to use the licensed IP. However, this exception does not appear to apply when identifying whether there are separate performance obligations.

Principal versus agent considerations

Some contracts result in an entity's customer receiving goods or services from another entity that is not a direct party to the contract with the customer. The standard states that when other parties are involved in providing goods or services to an entity's customer, the entity must determine whether its performance obligation is to provide the good or service itself (i.e., the entity is a principal) or to arrange for another party to provide the good or service (i.e., the entity is an agent).

The indicators that a performance obligation involves an agency relationship are based on indicators that are included in today's revenue recognition guidance in US GAAP and IFRS. However, the indicators in the new standard have a different purpose because they are based on the concepts of identifying performance obligations and the transfer of control of goods or services. Appropriately identifying the entity's performance obligation in a contract is fundamental to the determination of whether the entity is acting as an agent or a principal.

Entities involved in co-production, co-distribution and advertising arrangements and digital providers that distribute content may need to assess whether they are acting as a principal or an agent. M&E entities will need to consider the criteria under the new standard to assess the appropriate accounting for such transactions.

Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled and includes an estimate of any variable consideration, the effect of a significant financing component, the fair value of any noncash consideration and the effect of any consideration payable to a customer. The amount to which an entity expects to be entitled is meant to reflect the amount that the entity has rights to under the contract, which may differ from the price specified in the contract.

Variable consideration and the constraint

A portion of the transaction price could vary due to discounts, rebates, refunds, credits, incentives, bonuses or penalties, contingencies, or price concessions. For example, a film production arrangement may include a fee or refund due for a movie sequel not yet produced or an advertising contract may include a performance bonus. Additional examples of variable consideration include price protection offered to distributors and most-favored-nation clauses included in affiliate arrangements. A sales- or usage-based royalty for licensed IP is also variable consideration, but the standard provides a specific exception requiring that an entity include such consideration in the transaction price only when the subsequent sales or usage occurs. Refer to the License section above for a discussion of the sales- or usage-based royalty exception.

An entity estimates the transaction price using either the "expected value" or the "most likely amount" approach, whichever method better predicts the amount of consideration to which it expects to be entitled. The method selected is not meant to be a "free choice" and should be applied consistently throughout the contract and for similar types of contracts.

The variable consideration included in the transaction price may be constrained. That is, the standard limits the amount of variable consideration included in the transaction price to the amount for which it is probable that a subsequent change in estimated variable consideration will not result in a significant revenue reversal. A significant reversal occurs when a change in the estimate results in a significant downward adjustment in the amount of cumulative revenue recognized.

Illustration 2 — Estimating variable consideration

Advertising Agency A enters into a six-month advertising campaign agreement ($500,000 fixed fee) that also includes a potential $100,000 performance bonus linked to certain goals. The agency estimates it is 80% likely to receive the entire performance bonus and 20% likely to receive none of the bonus.

Because of the binary nature of the outcome (the agency either will or will not receive the performance bonus), Advertising Agency A determines that the "most likely" approach is the better predictor. The agency has significant experience with these types of arrangements and in estimating whether it will achieve the performance bonus. In addition, the uncertainty will be resolved in a short time frame (that is, at the end of the six-month campaign). Thus, the agency determines that it is probable that a significant reversal will not occur and includes $100,000, the entire performance bonus, in the transaction price. As a result, the agency would recognize revenue earlier than under today's guidance, which requires certain goals to be met and the performance bonus to be achieved before the $100,000 performance bonus can be recognized.

How we see it

Practice will change for M&E entities when assessing variable consideration (except for sales- and usage-based royalties on licenses of IP). The current multiple-element arrangement revenue recognition guidance in ASC 605-25 limits the recognition of revenue when such amounts are contingent upon the future performance of the entity. In addition, Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) Topic 13 requires the transaction price to be fixed or determinable in order to recognize revenue. The new standard does not contain either of these requirements.

Consideration payable to a customer

Many M&E entities make payments to their customers from time to time, such as slotting fees for placement of DVDs, book releases and CDs in retail stores; reimbursements under cooperative advertising arrangements in which a film company reimburses the reseller for a portion of the costs incurred by the reseller to advertise products; channel placement fees; and launch incentive fees paid by cable networks to multiple system operators (MSOs) or satellite companies to launch a new channel.

For a payment by an entity to a customer to be treated as something other than a reduction of the transaction price, the good or service provided by the customer has to be considered distinct. Because consideration paid to a customer can take many different forms, M&E entities will have to carefully evaluate each transaction to determine the appropriate treatment of such amounts. For example, slotting fees and launch incentive fees paid to customers may not provide a distinct good or service to the entity. In those circumstances, such fees paid to customers should be treated as a reduction of the transaction price, which is consistent with current practice.

Today's industry-specific M&E guidance for certain advertising barter arrangements is superseded by the new standard.

Cooperative advertising arrangements may or may not provide distinct goods or services, and a careful analysis of the facts and circumstances of the arrangements will be required to make this determination. Under today's guidance, arrangements that do not specify the amount or type of advertising that the customer must provide to qualify for the cooperative advertising payment may not provide enough information for the vendor to conclude that an identifiable benefit has been received. Under the new standard, an M&E entity may need to make a similar assessment when determining whether the customer's advertisements of the entity's products represent a distinct good or service.

Noncash consideration

Advertising exchanged for content

In certain license arrangements between producers and networks, a network may contribute cash and/or advertising on the network to the producer in exchange for the licensed rights. Today, producers recognize revenue from the sale of the licensed content when they use the advertising or sell it to a third party (even when the licensed content was previously transferred). Today's industry-specific M&E guidance for certain advertising barter arrangements is superseded by the new standard. Advertising barter is considered noncash consideration in the new standard.

The new standard requires the fair value of the advertising received to be included in the transaction price. This treatment differs from current guidance, under which the advertising is measured at its carrying amount (i.e., zero). If an M&E entity cannot reasonably estimate the fair value of the advertising, it should measure the value of advertising received indirectly by reference to the estimated selling price of the other promised goods or services in the contract, such as the licensed rights or the price of the programming.

Illustration 3 — Exchange of content for advertising time
Producer ABD licenses programming to Network XYZ in exchange for a specified amount of advertising time on Network XYZ when it broadcasts the licensed programming from Producer ABD. Producer ABD will separately negotiate with advertisers to sell the advertising time received as part of this transaction. Under the standard, Producer ABD will first estimate the overall transaction price for the licensed programming by determining the fair value of the advertising received, and if that is not reasonably estimable, Producer ABD can use the value of the programming licensed.

Advertising exchanged for advertising

Today's guidance on accounting for arrangements involving exchanges of advertising (e.g., internet advertising exchanged for television advertising) is prescriptive, and revenue and expenses are recognized at fair value. The fair value of the advertising surrendered is determinable based on an entity's own historical practice of receiving cash or instruments convertible to cash for similar advertising. Today, the population of prior cash transactions that is utilized to determine fair value typically is limited to transactions entered into within six months prior to the date of the barter transaction. In addition, the advertising should be similar to the bartered advertising with respect to market, timing, prominence, demographics and duration. If the fair value of the advertising surrendered is not determinable, the advertising barter transaction is recorded based on the carrying amount of the advertising surrendered, which likely is zero.

Under the new standard, entities will need to use more judgment when analyzing the specific facts and circumstances of advertising barter transactions. An entity will need to first assess whether the arrangement meets the criteria to be considered a contract with a customer, including whether the contract has commercial substance (that is, the contract is expected to change "the risk, timing or amount of the entity's future cash flows"). If the entity determines the arrangement is a contract with a customer, it will include the fair value of the advertising received in the transaction price for the advertising sold. Accounting for advertising received at its fair value is a change from today's guidance, under which an entity generally looks first to the fair value of the goods or services surrendered and then to the fair value of the asset acquired if it was more clearly evident.

Rights of return

An entity may provide its customers with a right to return a transferred product. Offering a right of return in a sales agreement obliges the selling entity to stand ready to accept a returned product. The Boards concluded that an entity should not recognize revenue for sales that are expected to fail as a result of the customer exercising its right to return the goods. Instead, the potential for customer returns should be considered when an entity estimates the transaction price because potential returns cause consideration to be variable. This applies to M&E entities that sell physical goods to retailers, such as DVDs, CDs and books.

While the recognition and measurement for rights of return under the new standard may not significantly change from current practice, there are some notable differences. Under the new standard, an entity will estimate the transaction price and apply the constraint to the estimated transaction price (except for a sales-based royalty for licensed IP). In doing so, it will estimate potential returns expected and record a refund liability for the obligation to return the customer's consideration.

Finally, when customers exercise their rights of return, the entity may receive the returned product in salable or reparable condition. Under the new standard, at the time of the initial sale (when recognition of revenue is deferred due to the anticipated return), the entity recognizes a return asset (and adjusts cost of sales) for its right to recover the goods returned by the customer. Changes from current practice include recognizing a return asset, estimating the carrying value, testing it for impairment and presenting the refund liability separately from the corresponding asset.

How we see it

The changes in this area (primarily treating the right of return as a type of variable consideration that must be put through the variable consideration model, including the constraint) may affect the sale of retail goods in the M&E industry. M&E entities will have to assess whether their current models for estimating returns are appropriate, given the need to consider the constraint.

Allocate the transaction price to the performance obligations

Once the performance obligations have been identified and the transaction price has been determined, an entity will allocate the transaction price to the performance obligations generally in proportion to their standalone selling prices (i.e., on a relative standalone selling price basis), with limited exceptions. An entity will need to allocate variable consideration to one or more, but not all, performance obligations in some situations. The standard also contemplates the allocation of any discount in an arrangement to one or more, but not all, performance obligations, if specified criteria are met. The transaction price is not reallocated to reflect changes in standalone selling prices after contract inception.

When determining standalone selling prices, an entity must use observable information, if available. If standalone selling prices are not directly observable, an entity will need to make estimates based on information that is reasonably available. Examples of estimation methods include an adjusted market assessment approach or an expected cost plus a margin approach. Entities should apply estimation methods consistently in similar circumstances.

The concept of allocating the transaction price is not significantly different from today's guidance in Accounting Standards Codification (ASC) 605-25, but there is no longer a prescriptive hierarchy for how to perform the allocation of transaction price. The presence of contract terms such as cross-collateralized films, potentially refundable amounts or contingent performance do not preclude an entity from allocating the transaction price to each performance obligation.

Illustration 4 — Allocating the transaction price

Film Company A grants a customer the broadcast rights to three films under a single licensing arrangement. The arrangement includes a fixed fee of $30,000. At the date of the arrangement, Films 1 and 2 are complete; Film 3 has not yet been produced. The arrangement provides for a pro rata reduction in the license fee if Film 3 is not completed and made available for delivery.

Film Company A determines that each film represents a separate performance obligation. The $10,000 subject to refund if Film 3 is not delivered is considered variable consideration. Using the most likely amount approach, Film Company A estimates the transaction price to be $30,000 and then applies the constraint. Film Company A determines that it is 75% likely that it will deliver Film 3 and that it is probable that a significant revenue reversal will not occur. Therefore, Film Company A includes the $10,000 subject to refund in the total transaction price of $30,000.

The $30,000 transaction price is allocated to each film based on the relative selling price of each film. The standalone selling price is the price at which Film Company A would sell each film separately to a customer. Assume the standalone selling prices for films 1, 2 and 3 represent 40%, 35% and 25% of the total transaction price, respectively. The transaction price allocated to each film is $12,000 for Film 1, $10,500 for Film 2 and $7,500 for Film 3. This contrasts with today's industry guidance that requires that the amount that is refundable be allocated to the undelivered film. Therefore, today the refundable portion ($10,000) is allocated entirely to the film remaining to be delivered (Film 3), and the remainder ($20,000) is allocated to the completed films (1 and 2) based on their relative fair values.

Allocation of nonrefundable minimum guarantees

Nonrefundable minimum guarantees are common in M&E licensing transactions when, for example, a producer licenses a film in exchange for a sales-based royalty to be recouped in excess of a nonrefundable minimum guarantee.

Under today's film guidance in ASC 926-25-19, the nonrefundable minimum guarantee typically is recognized at the beginning of the license period, unless the nonrefundable minimum guarantee is applied against the sales-based royalty on films that are cross-collateralized. Instead, for films that are cross-collateralized, the sales-based royalty for each film in the licensing arrangement is recognized as earned (e.g., based on movie theater ticket sales) and any portion of the minimum guarantee in excess of the total sales-based royalty is recognized at the end of the license period.

M&E entities may need to use judgment when assessing whether control has transferred and the performance obligation has been satisfied.

The presence of contract terms such as cross-collateralized films does not preclude an entity from allocating the transaction price to each performance obligation under the new standard. Therefore, the nonrefundable minimum guarantee would be allocated to each performance obligation (e.g., each film) based on the relative selling price of each film and recognized as revenue in the period each film's performance obligation is satisfied.

MSO agreements

When cable networks contract with cable providers (e.g., MSO, satellite), the MSO agreements are typically multi-year arrangements under which the monthly rate per subscriber escalates each year. MSO agreements also typically include most favored nation clauses that require the monthly rate per subscriber to remain within certain ranges of the competitor cable providers. Under today's guidance, the cable networks allocate (and subsequently recognize) revenue based on the contractual monthly rate per subscriber. Under the new standard, cable networks will have to assess whether the monthly rate per subscriber represents the relative standalone selling price for purposes of allocating revenue to be recognized as monthly services are provided.

Satisfaction of performance obligations

An entity recognizes revenue only when it satisfies a performance obligation by transferring control of a promised good or service to the customer. Control of a promised good or service refers to the ability to direct the use of and obtain substantially all of the remaining benefits of the good or service. The transfer of control can occur over time or at a point in time. A performance obligation is satisfied at a point in time unless it meets one of the following criteria for being satisfied over time:

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.

- The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

When a performance obligation is satisfied over time, the standard requires an entity to select a single method (either an input method or an output method) to measure progress for each performance obligation that best depicts the entity's performance in transferring the good or service. For example, when a customer purchases an on-demand movie from a cable company, control transfers to the customer once the customer is provided access. The standard provides indicators of when control transfers, including right to payment, legal title, risk and rewards of ownership, physical possession and acceptance.

Illustration 5 — Satisfaction of performance obligations

A publisher provides a customer with the service of a one-year subscription to educational software accessible online (including content updates and test scoring) with the purchase of textbooks. The customer can benefit from the physical textbook on its own and from the educational software through the use of a computer.

Assume that both the good (physical book) and online service are capable of being distinct and are distinct within the context of the contract. However, in this example, the one-year subscription to educational software and the book may have different patterns of transfer. That is, the publisher transfers control of the physical book to the customer at a point in time upon delivery (depending on shipping terms). The publisher determines that the pattern of transfer for the educational software is over time because the publisher is providing the customer with a one-year subscription to software accessible online with continuous updates (the first criterion above is met).

Restrictions on distribution (e.g., street date)

In the film, video game, music and publishing industries, contracts often include certain restrictions on the locations and dates a customer can distribute the product (e.g., street date), which affects the determination of when control transfers. Because of these restrictions, the customer may not have the "present right" to obtain substantially all of the potential cash flows from that asset until the street date. The concept of a street date may also indicate that control has not transferred to the customer. In this scenario, an M&E entity may conclude that the transfer of control of the product would not occur until the street date because the retailer does not have the ability to direct the use of and receive the benefit from the good until it is permitted to sell the product. Today, the concept of street date is included in film industry accounting guidance; however, the assessment of street date and the restrictions the retailer may have vary among M&E industries (e.g., music and publishing). The street date concept is not specifically discussed in the new standard, and M&E entities will have to apply judgment to determine the appropriate point for revenue recognition.

For example, an M&E entity enters into a licensing arrangement to promote a film through the distribution of film-related merchandise. This often occurs prior to the film's release. Today's film guidance in ASC 926-605 restricts an entity from recognizing revenue from licensing arrangements to market film-related products until it releases the film. Under the new standard, M&E entities will need to consider the facts and circumstances of the arrangement to determine whether the entity has satisfied the performance obligation for the promotional activities (assuming those activities are a separate performance obligation from the film license). In many cases, M&E entities may recognize revenue from licensing arrangements to market film-related products earlier than they do today because the restriction in today's guidance is not included in the new standard.

How we see it

For certain products or services in the M&E industry, determining when control transfers and revenue should be recognized will be straightforward. However, in other circumstances (e.g., when performing promotional activities), this determination will be more complex. M&E entities should carefully assess when the customer has the ability to direct the use of and receive substantially all of the remaining benefits from an asset.

The standard provides specific implementation guidance to determine when control transfers for a license of IP. See the License section above.

Other considerations

Contract costs

Along with the guidance in ASC 606, ASC 340-40 was added to codify the guidance on other assets and deferred costs relating to contracts with customers. Incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) are capitalized but only when the costs are expected to be recovered (either directly or indirectly). In addition, costs to fulfill a contract, if not within the scope of other applicable literature, are capitalized if certain criteria are met.

This new cost guidance does not replace existing cost guidance included in M&E industry guidance such as the following:

- Costs of rights for program materials for broadcasters (ASC 920-350)
- Programming and other system costs during the prematurity period and successful franchise application costs (ASC 922-350)
- Initial subscriber installation costs (ASC 922-360)
- Film or episodic television series production costs (ASC 926-20)
- Artist compensation costs and record master costs (ASC 928-340)

M&E entities that follow today's industry-specific cost guidance will continue to follow it after they adopt the new standard. However, M&E entities may capitalize certain additional contract costs that are not covered by industry-specific or other cost guidance, if they meet the criteria in the new standard. For example, sales commissions earned on obtaining new affiliate agreements or agreements for international distribution of film or television content may be eligible for capitalization if those costs would not have been incurred if the contract had not been obtained. Such costs represent costs to obtain a contract and would be capitalized for contracts longer than one year.

Direct-response advertising

M&E entities may use direct-response advertising to elicit sales from a customer (e.g., magazine advertisements that include order coupons for an entity's products or direct response television ads). The costs of direct-response advertising may be capitalized when certain criteria are met under today's guidance in ASC 340-20 on capitalized advertising costs. This guidance in ASC 340-20 has been superseded and has not been replaced with industry-specific guidance. In assessing whether direct-response advertising costs can be capitalized under the new guidance, entities will have to determine whether such costs meet the definition of incremental costs of obtaining a contract with a customer.

Customer options for additional goods

The standard states that when an entity grants a customer the option to acquire additional goods or services, that option is a performance obligation only if it provides a material right to the customer.

M&E entities often incorporate optional purchases into contracts with customers, such as a coupon for a digital version of a textbook that is offered with the purchase of the physical textbook. If the coupon for the digital version of a textbook is provided to all customers who buy the physical textbook, the right may not be considered material. Another common example in the M&E industry is an option to provide additional seasons (or the right of first refusal of additional seasons) that a producer may include when it enters into license arrangements with a television network for season one of a television show. The licensee's decision to exercise the option for additional seasons depends on the success of the previous season, and therefore the price of each additional season may represent its standalone selling price. However, it is important to assess at the beginning of the contract whether the option represents a material right that is only given to that customer.

Measurement of options that are separate performance obligations

An M&E entity that determines that an option is a separate performance obligation has to determine the standalone selling price of the option. In most cases, the M&E entity does not sell the option on a standalone basis and therefore will have to estimate the standalone selling price. This may require significant judgment. The standard also provides an alternative to estimating the standalone selling price of an option. This practical alternative applies when the goods or services are both (1) similar to the original goods and services in the contract and (2) provided in accordance with the terms of the original contract (typically those types of options are for contract renewals). An entity includes the optional goods and services with the other identified performance obligations in the contract and includes the consideration related to the optional goods or services in the estimated transaction price.

Illustration 6 — Measuring options that are separate performance obligations

Publisher A sells a physical textbook for $10 and offers the customer an option to purchase the digital version of the publication for 50% off the retail price of $8. The typical discount for digital versions is 15%. Therefore, this discount is incremental to the typical discount offered to customers and provides the customer with a material right.

To estimate the standalone selling price of the option, Publisher A estimates there is a 50% likelihood that a customer will redeem the discount option. Therefore, Publisher A's estimated standalone selling price of the discount option is $1.40 ($8 digital price x 35% incremental discount x 50% likelihood of exercising the option).

Publisher A allocates $1.23 {$10 x [$1.40 / ($1.40+$10)]} of the transaction price to the discount option and recognizes revenue for the option when the customer redeems it for the digital version or when it expires. Publisher A allocates $8.77 ($10 — $1.23) to the physical book and recognizes revenue for the physical book when control transfers.

Next steps

M&E entities should perform a preliminary assessment of how they will be affected as soon as possible so they can determine how to prepare to implement the new standard. While the effect on entities will vary, some may face significant changes in revenue recognition. All entities will need to evaluate the requirements of the new standard and make sure they have processes and systems in place to collect the necessary information to implement the standard, even if their accounting results won't change significantly or at all.

In particular, M&E entities should begin to assess their licenses of IP to understand how certain activities they perform may affect the determination of whether the license represents a *right to use* (i.e., point in time revenue recognition) or a *right to access* (i.e., over time revenue recognition).

Applying some aspects of the standard will require significant judgment. As such, M&E entities should ensure they have adequate policies and procedures in place to support their judgments and application of the standard.

M&E entities also may want to monitor the discussions of the Boards, the SEC staff and the TRG as they discuss various interpretations of how the new standard will be applied to common transactions.

Public entities also should consider how they communicate the changes with investors and other stakeholders, including their plans for disclosures about the effects of new accounting standards discussed in SAB Topic 11.M. The SEC staff has indicated it expects an entity's disclosures to evolve in each reporting period as more information about the effects of the new standard becomes available, and the entity should disclose its transition method once it selects it.

Endnotes:

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[1] The FASB defined public entity for purposes of this standard more broadly than just entities that have publicly traded equity or debt. The standard defines a public entity as one of the following: (1) a public business entity, (2) a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market, or (3) an employee benefit plan that files or furnishes financial statements with the SEC.

Appendix

The following M&E guidance in US GAAP will be superseded by the new revenue recognition standard:

920-310	Entertainment — Broadcasters — Receivables
920-405-25-2	Entertainment — Broadcasters — Liabilities — Recognition — Barter Transactions
920-605	Entertainment — Broadcasters — Revenue Recognition
920-845	Entertainment — Broadcasters — Nonmonetary Transactions
922-430	Entertainment — Cable Television — Deferred Revenue
922-605	Entertainment — Cable Television — Revenue Recognition
924-605	Entertainment — Casinos — Revenue Recognition
926-430	Entertainment — Films — Deferred Revenue
926-605	Entertainment — Films — Revenue Recognition
926-845	Entertainment — Films — Nonmonetary Transactions
928-430	Entertainment — Music — Deferred Revenue
928-605	Entertainment — Music — Revenue Recognition