Joint revenue recognition project – key issues in media and entertainment

July 2012
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What you need to know

- The IASB and the FASB have completed their evaluation of feedback received via comment letters and outreach efforts.
- While respondents in the media and entertainment industry generally support the Boards’ progress on the 2011 proposal, many still have significant concerns about certain aspects of the proposal, including when revenue would be recognised for licence agreements, non-cash consideration, onerous performance obligations, interim and annual disclosure requirements and transition.
- Media and entertainment entities also requested additional application guidance on other aspects of the proposal.
- Re-deliberations will begin in July 2012 and are expected to continue through to December 2012.
Overview
The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards) jointly issued an exposure draft (ED) Revenue from Contracts with Customers in November 2011 that would supersede virtually all existing revenue guidance in IFRS and US GAAP. The ED specifies the accounting for all revenue arising from contracts to provide goods or services to customers (except for contracts that are in the scope of another standard, such as leases). The comment period on the Boards’ proposal ended in March 2012.

Respondents in the media and entertainment industry are especially concerned that the proposal would require them to recognise intellectual property (IP) licence revenue up-front rather than over time. In addition, under the new model, a single arrangement to license content could end up being accounted for as multiple transactions for revenue recognition purposes. Respondents are also concerned that the proposal would likely change revenue recognition for licensing arrangements between TV content providers and distributors that exchange advertising.

The Boards have begun re-deliberations. In a plan recently outlined, they will address issues raised by respondents in various industries. The topics include whether a revenue standard should require the recognition of liabilities for onerous performance obligations, applying the proposal to time-based licences and licences bundled with service contracts, and balancing the desire of financial statement users for more information with preparers’ concerns about the cost and practicality of the proposed disclosures. However, it is not clear how the Boards plan to provide additional application guidance.

Approximately 350 comment letters have been submitted to the IASB and the FASB, compared with more than 950 comment letters for the previous ED issued in 2010. While respondents are generally supportive of the Boards’ progress in addressing constituents’ concerns on the 2010 ED, many still have concerns and are seeking clarity about certain aspects of the ED.

In addition to soliciting feedback on the ED through comment letters, the Boards participated in over 200 outreach events in recent months. As part of their outreach, the Boards sought feedback from users, preparers, accounting firms, regulators and standard setters.

Significant feedback received from the media and entertainment industry respondents
This publication summarises the more significant themes of the feedback received from the media and entertainment industry, as well as the Boards’ proposed next steps.

Satisfaction of performance obligations
The proposal would require entities to determine whether a performance obligation is satisfied over time based on certain criteria. However, for entities that grant a customer a licence to use IP, the proposal states that the performance obligation would be satisfied when the customer obtains control of the rights, which generally would be at a point in time. Most respondents raised concerns about this, saying that recognising revenue over time is appropriate for many licences because the performance obligation is satisfied over time. For example, certain licence agreements (e.g., sports licences) include the sports organisation’s involvement throughout the licence term.

Many IP licence agreements also include restrictions on the use of the IP during the licence term. The restrictions may include windows (e.g., use of IP during years 1 and 3 but not year 2) or may include a requirement to broadcast TV shows on a linear basis (i.e., episode 1 must occur before episode 2). These types of restrictions or continued involvement by the licensor may lead to different conclusions about when transfer of control occurs, say respondents.

Respondents also argue that the proposed guidance to immediately recognise revenue for licensed IP would not reflect the underlying economics of these arrangements. To promote consistent application, respondents asked the Boards to clarify when revenue should be recognised over time versus at a point in time. During the re-deliberations, the Boards will further consider how the proposal would apply to various licence arrangements.
Determine the transaction price

The proposal would require the fair value of non-cash consideration received from a customer to be included in the transaction price. However, the cumulative amount of revenue entities could recognise would not exceed the amount to which the entity is reasonably assured. In certain licence arrangements between content providers and distributors, such as TV or cable networks, the distributor contributes cash and/or advertising on its network in exchange for the licensed rights. Today, most content providers recognise revenue from the sale of the licensed content when the advertising is sold to a third party, even though the licensed content had been transferred previously. In a change from current practice, the proposal would require the fair value of the advertising to be included in the transaction price. This amount would be recognised when the licensed rights are transferred, which would likely accelerate revenue recognition.

Respondents also believe the proposal does not clearly indicate whether the fair value of barter advertising would be measured, i.e., when control is transferred and the licence period begins, or when the advertising is sold. If the fair value of the asset (advertising) received as part of the consideration is measured at the inception of the licence period, an entity could recognise additional revenue when the content is provided to the distributor. Revenue would also be recognised when the advertising inventory asset is subsequently sold by the content provider.

Respondents also requested clarification on the classification of the sale of advertising assets obtained from licensing content, and whether the derecognition of an asset should be recorded against the revenue from the sale of the advertising or separately as a cost of goods sold. It is unclear how the Boards will address these issues.

Onerous performance obligations

The proposal would require entities to recognise a liability and corresponding expense for onerous performance obligations that are satisfied over a period greater than one year. Almost all respondents disagreed with the Boards’ proposal, and some questioned whether the onerous assessment should be included in a revenue standard at all. If the onerous assessment remains in the standard, respondents said the test should be performed at the contract level. Others expressed concern about the proposed requirement to make the assessment only for performance obligations satisfied over a period greater than one year.

Respondents also raised concerns that the proposal does not consider that media and entertainment entities realise assets through multiple revenue streams. This is common for cable networks that provide services to multiple cable distributors. The programming costs are realised through a dual revenue stream of both cable or satellite affiliate fees and advertising revenue. The onerous test would be determined by assessing each performance obligation in a contract with a customer (e.g., consideration of performance obligations with a single agreement with a distributor). As such, although an individual performance obligation may be deemed onerous, this would not be the case when it is considered together with all of the performance obligations in the contract as a whole.

Respondents believe that the evaluation should be based on the overall costs and performance obligations existing in a single contract.

The Boards indicated that they would consider whether it was appropriate to include an onerous test in a revenue standard and, if so, what the appropriate unit of account should be. The Boards also indicated that they would re-deliberate the scope of the test (i.e., applicable to all performance obligations or just those satisfied over time) and what costs that should be included in the onerous test.
Contract acquisition costs

The proposal would require entities to capitalise contract acquisition costs they expect to recover. However, if the contract period is less than one year, an entity could choose to recognise contract acquisition costs as an expense in the period incurred. Entities in the media and entertainment industry (e.g., cable operators) commonly incur costs to obtain contracts. Respondents believe that capitalising contract acquisition costs should be an option. The Boards indicated they will consider further the effects of requiring contract acquisition costs to be capitalised, including practical application challenges and the effect on comparability.

Disclosure

The Boards proposed certain disclosures on an interim and annual basis to help users understand the nature, amount, timing and uncertainty of revenue and cash flows that arise from contracts with customers. While preparers are generally supportive of the qualitative disclosures, they said that the quantitative disclosures (for example, the account reconciliations) are too prescriptive and are not consistent with the information that management uses to run the business. Preparers also expressed concern about meeting interim financial reporting deadlines given the volume of proposed disclosures.

Users of the financial statements are generally supportive of the proposed interim and annual disclosures. However, some are concerned that the volume of disclosures may obscure useful information. Therefore, the Boards plan to engage users and preparers in future outreach activities to balance the needs of users with the information that preparers can provide at a reasonable cost on a timely basis.

Transition

There is support for both retrospective and prospective application of the new standard on transition. Many preparers have requested prospective adoption because they believe retrospective application would be impractical, especially for entities with long-term contracts. These respondents believe that the significant costs to retrospectively apply a final standard would outweigh the benefits to users. Some respondents believe retrospective adoption of the new standard should be an option. However, many users also expressed a preference for retrospective application.

In their re-deliberation plan, the Boards indicated that they would give further consideration to whether the users’ needs for comparative information for prior periods could be met with any transition approach other than retrospective application (e.g., prospective application supplemented with additional disclosures about the effect of transition). The Boards also indicated that their conclusions on this matter would directly affect the effective date for the new revenue standard.

Next steps

Re-deliberations began in July and are expected to continue throughout 2012. Refer to the Appendix for a summary of the Boards’ re-deliberation plan, which outlines the agenda items and the approximate timing of the discussions of each topic. The Boards have targeted early 2013 for issuance of a final standard.

Constituents are encouraged to monitor the Boards’ re-deliberations for possible changes to the proposal.
Appendix: Re-deliberation plan

The Boards discussed the IASB and FASB staff’s re-deliberation plan. The Boards may decide to address the topics in a different order and/or may decide that they need more time for certain topics.

<table>
<thead>
<tr>
<th>Date</th>
<th>Topic</th>
<th>Aspect of the proposal the Boards intend to discuss</th>
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| July 2012       | Identifying separate performance obligations | - The interaction of paragraphs 28 and 29  
                   |                                             | - The nature of performance obligations arising from a promise to stand ready to provide goods or services (for example, when-and-if available software updates)  
                   |                                             | - Application of the practical expedient in paragraph 30 and effect on other aspects of the proposal (such as the onerous test) |
|                 | Satisfaction of performance obligations    | - How the criteria in paragraph 35 would apply to service contracts  
                   |                                             | - The “alternative use” criterion in paragraph 35(b)  
                   |                                             | - The “right to payment for performance to date” criterion in paragraph 35 (b)(iii)  
                   |                                             | - The accounting for uninstalled or wasted materials  
                   |                                             | - Use of the units of delivery method to measure progress  
                   |                                             | - Application of the criteria in paragraphs 35 and 36 to various types of contracts, including residential real estate transactions |
|                 | Licences                                   | - Application of the proposal to time-based licences and licences bundled with service contracts |
|                 | Onerous performance obligations            | - Whether the proposal should include an onerous test  
                   |                                             | - Unit of account and scope of the onerous test  
                   |                                             | - Types of costs that should be included in the test |
| September 2012  | Combination and modification of contracts  | - When contracts can or should be combined  
                   |                                             | - Contract modification requirements |
|                 | Constraining the cumulative amount of revenue recognised | - Whether the constraint should apply to the measurement of revenue, allocation of the transaction price and/or the recognition of revenue  
                   |                                             | - The description of ‘reasonably assured’ and whether the constraint should include a quantitative assessment  
                   |                                             | - Scope and necessity of the specific constraint for recognising sales-based royalties on licensed intellectual property  
                   |                                             | - Application of the constraint to transactions or industries that currently adopt different approaches to the accounting for variable consideration (such as, asset management contracts and contracts between an entity and its distributor)  
<pre><code>               |                                             | - Application of the constraint to the sales of non-financial assets |
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| September 2012 | Collectibility            | • Whether impairment losses should be required to be presented in the income statement or could be disclosed in the notes to the financial statements (if not material)  
• Presentation of impairment losses when an entity has revenue from sources other than contracts with customers  
• Whether subsequent measurement of credit risk should be presented in a separate line item adjacent to revenue  
• Interaction between the proposal and the Boards’ financial instruments project on impairment  
• Whether revenue should be recognised only when a minimum threshold for customer credit risk has been met or exceeded |
|              | Time value of money       | • When a contract includes a 'significant' financing component  
• Costs versus benefits of compliance  
• Usefulness of accounting for the time value of money  
• Relevance of a one-year practical expedient |
| October 2012  | Scope                     | • Definition of a customer, particularly in collaborative arrangements  
• Interaction between the proposal and other joint projects on leases, financial instruments and insurance contracts |
|              | Contract costs            | • Practical challenges to capitalising costs to obtain a contract and the effect on comparability in some industries |
|              | Allocating the transaction price to separate performance obligations | • Use of the residual approach to estimate stand-alone selling prices  
• Basis for allocating discounts and/or variable consideration |
|              | Non-financial assets      | • Appropriateness of applying the measurement and recognition aspects of the proposal to the transfer of non-financial assets |
| November 2012 | Disclosures               | • Costs versus benefits of compliance on an interim and annual basis  
• Usefulness of disclosures to financial statement users  
• Interim reporting requirements  
• Needs of public versus non-public users (FASB only) |
|              | Transition, effective date and early adoption | • Costs versus benefits of retrospective application  
• Alternative transition methodologies  
• Selection of an effective date |
| December 2012 | Other, including cost-benefit analysis and consequential amendments | • Overall analysis of the relative costs and benefits of applying the proposal |
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