Making sense of a complex world
Revenue recognition: payments to customers – issues for media companies

This paper explores some of the key IFRS accounting considerations for payments by media companies to their customers.
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Introduction to MIAG

Our Media Industry Accounting Group (MIAG) brings together our specialist media knowledge from across our worldwide network. Our aim is to help our clients by addressing and resolving emerging accounting issues that affect the entertainment & media sector.

With more than 3,575 industry-dedicated professionals, PwC’s global entertainment & media practice has depth and breadth of experience across key industry sectors including: television, film, advertising, publishing, music, internet, video games, radio, sports, business information, amusement parks, casino gaming and more. And just as significantly, we have aligned our media practice around the issues and challenges that are of utmost importance to our clients in these sectors. One such challenge is the increasing complexity of accounting for transactions and financial reporting of results – complexity that is driven not just by rapidly changing business models but also by imminent changes to the world of IFRS accounting.

Through MIAG, PwC aims to work together with the entertainment & media industry to address and resolve emerging accounting issues affecting this dynamic sector, through publications such as this one, as well as conferences and events to facilitate discussions with your peers. I would encourage you to contact us with your thoughts and suggestions about future topics of debate for the MIAG forum, and very much look forward to our ongoing conversations.

Best wishes

Sam Tomlinson
PwC UK
Chairman, PwC Media Industry Accounting Group

1 PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal company
Revenue recognition: payments to customers

Revenue is – hopefully! – the largest item in the income statement so accounting judgements that directly affect revenue are invariably important. Our seventh MIAG paper explores some of the key IFRS accounting considerations when media companies make payments to their customers.

Payments to customers can present accounting challenges in many sectors, but particularly in a fast-evolving media and technology landscape where two companies are frequently both supplier to, and customer of, each other.

A media company’s assessment of whether payments to its customers are independent or directly linked to sales transactions determines whether the company recognises these payments as costs or deductions from revenue. This in turn affects two key metrics in opposite directions: revenue and percentage profit margin. Careful communication of appropriate revenue recognition accounting policies for payments to customers is therefore a key part of managing capital markets stakeholders.

This paper considers the assessment of payments to customers in various practical examples, covering the purchase of advertising space, physical and digital ‘slotting fees’, outsourced advertising sales and video game prizes. Our scenarios are clearly not designed to be exhaustive; but they will hopefully provide food for thought for media companies when considering how to account for payments to their customers.

We hope that you find this paper useful and welcome your feedback.

Best wishes

Sallie Deysel
PwC UK
PwC Media Industry Accounting Group

Sallie Deysel
Revenue in the media sector can arise from the sale of goods or rendering of services in areas as diverse as books, newspapers, magazines, music, film, television, video games and more. A relatively common feature of the fast-evolving media and technology landscape is for two companies to be both supplier to, and customer of, each other. A media company making payments to its customers must assess whether these payments:

- represent consideration for goods or services supplied by customers, which are purchased independently of the sales made to those customers, in which case the payments are generally presented in the income statements as costs; or
- would not have been made independently of the sales transaction with those customers, in which case the payments are presented as deductions from revenue.

A media company making payments to its customers must assess whether these payments:

- represent consideration for goods or services supplied by customers, which are purchased independently of the sales made to those customers, in which case the payments are generally presented in the income statements as costs; or
- would not have been made independently of the sales transaction with those customers, in which case the payments are presented as deductions from revenue.

Sometimes it might be obvious that two transactions are entirely independent – but other times it might not be. This assessment is becoming even more complicated as digital transformation generates an ever-increasing network of interconnected relationships that do not have the benefit of historical experience or practice to inform the accounting judgements.

What is the relevant IFRS guidance?

IAS 8 Accounting policies requires a company’s accounting policies to ‘reflect the economic substance of transactions, other events and conditions, and not merely their legal form’. Accordingly, IAS 18 Revenue recognition requires that two or more transactions should be treated as a single transaction if and when they are ‘linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole’.

Complications arise and warrant careful consideration where media company M sells a product or service to customer C and that same customer C seemingly sells a different product or service back to M. The issue for media company M in preparing its accounts is whether the two transactions should be regarded as two separate contracts or as one larger contract.

Factors that indicate independent transactions (and hence gross income statement presentation) might include:

- C selling the same product or service to other third parties that it has sold to M
- M having no obligation to purchase the product or service from entity C
- Arm’s length market prices (i.e. fair value) for each transaction

Factors that indicate linked transactions (and hence net income statement presentation) might include:

- Transactions are entered into in close proximity to each other and/or their mutual existence is acknowledged in the separate contracts
- Lack of sufficient evidence to support fair value for each transaction
- M does not have a clear business need for the product or service it is purchasing from C
- M would not have made the payment if it were not also selling a good or service to C.

Sometimes, considering whether the cash transactions between the company and the counterparty are settled gross or net can provide further evidence to support the conclusion reached on income statement presentation. However, in general the method of settlement (gross or net) is a less determinative indicator than the items listed in the bullets above.

These indicators are not a complete list; nor must all of them have been met to confirm that transactions are either independent or linked. Indeed, in practice, some indicators might suggest
independent transactions, while other indicators suggest the reverse. Relevant indicators are therefore considered as a whole to assess the economic substance of the arrangement, with the greater weight being assigned to the most important. In some cases a seemingly small change in the relevant facts and circumstances can significantly affect the assessment.

This paper considers the assessment of payments to customers by media companies in various practical examples, covering the purchase of advertising space, physical and digital ‘slotting fees’, outsourced advertising sales and video game prizes. Our scenarios are clearly not designed to be exhaustive; but they will hopefully provide food for thought for media companies when considering how to account for payments to their customers. As always, the answer for complicated real life arrangements will depend on specific facts and circumstances.

**Are there any tax implications?**

This paper is concerned primarily with accounting, which should be consistent across companies reporting under IFRS, rather than tax, which will vary with each country’s local laws and tax regulations. We note that sales tax is generally calculated as a percentage of revenue; so the assessment of payments to customers, which impacts revenue recognition, might also affect sales tax.

Some countries may have tax legislation specifically designed to address payments to customers, in which case the accounting treatment adopted should in theory be tax neutral. However, even in such countries, the accounting treatment adopted might have implications with regards to sales tax, since differing treatments for accounting and tax purposes might raise the attention of local tax authorities or accounting regulators. Direct tax authorities will also pay close attention to payments between related group companies to understand the substance of intra-group transactions.

We would always recommend consulting with a local tax expert to determine possible tax consequences of payments to customers.
Example 1: Buying advertising space

Scenario
NewsCo regularly sells advertising space in its print newspapers to TVCo. Occasionally, NewsCo also pays TVCo for advertising spots on its television channels. Each year, the total advertising sold by NewsCo to TVCo is worth considerably more than the amount bought by NewsCo from TVCo (i.e. TVCo does more advertising than NewsCo).

The NewsCo print ad sales contracts and the TVCo television ad sales contracts are all independent contracts that are signed at different times and make no reference to each other. The cash payments are also settled independently. Both NewsCo and TVCo also sell advertising space to numerous other advertisers at similar rates to those charged to each other.

How should NewsCo account for its advertising on TVCo’s television channels?
NewsCo must assess whether its payments to TVCo for television advertising:

- represent consideration for an advertising service that has been purchased independently of print advertising sales to TVCo, in which case NewsCo would present the payments as operating costs in its income statement; or
- are directly linked to print advertising sales to TVCo, in which case NewsCo would generally offset the payments against revenue.

We focus here on NewsCo since the balance of cash flows in this scenario mean that NewsCo is the main supplier with TVCo as the customer; but TVCo would also need to make its own assessment of how to present these payments and receipts in its income statement.

Assessment of key indicators
An indicative assessment by NewsCo for the key indicators might be:

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Assessment by print newspaper NewsCo</th>
</tr>
</thead>
</table>
| Obligation to purchase the product or service from customer (i.e. from TVCo) | • There are no indications that TVCo obliges NewsCo to buy television advertising space  
• NewsCo gets a benefit from the advertising that is independent of whether it makes a sale to TVCo  
• It would therefore be assumed NewsCo has a genuine business need to buy this advertising  
• Indicator suggests transactions are independent i.e. NewsCo would present payments to TVCo as operating costs |
| Independent contracts at different times with no reference to each other | • Contracts are signed separately and make no reference to each other  
• Indicator suggests transactions are independent i.e. NewsCo would present payments to TVCo as operating costs |
Conclusions

In summary, NewsCo’s payments to TVCo for television advertising space appear to be for the purchase of a separately identifiable service at a market rate from TVCo. NewsCo would therefore present these payments as an operating cost in its income statement (not as a deduction from revenue).

However, if some of the facts and circumstances were varied, the determination could be different. For example, NewsCo’s contract to sell print advertising space to TVCo might also have committed NewsCo to buy television advertising at inflated rates and the contracts might have been signed on the same day. In such a scenario, NewsCo might deem the transactions to be inextricably linked, in which case it would present the payments to TVCo as a deduction from revenue in its income statement.

Further complications arise if the sales of advertising space in each direction are deliberately set equal to each other, with no possibility of cash changing hands – i.e. the arrangement is ‘barter’. In barter transactions, the threshold for gross recognition of revenues and costs is set deliberately high: the services being exchanged must be of dissimilar nature, and the seller must have evidence of fair value from similar frequently occurring non-barter transactions with other third parties.

If NewsCo and TVCo were exchanging print and television advertising with no cash settlements in either direction, they would pass the ‘dissimilar’ test but would still be required to demonstrate that the respective sales were at fair value if they wished to recognise revenues and costs separately. And if they were instead trading the same advertising medium – for example, exchanging advertising space on their respective websites – it is likely they would each regard the services as ‘similar’ and not recognise the respective revenues or costs.

### Indicator Assessment by print newspaper NewsCo

**Customer (TVCo) selling same product or service to other third parties**
- TVCo (and NewsCo) does indeed sell advertising space to third parties in the normal course of business
- **Indicator suggests transactions are independent i.e. NewsCo would present payments to TVCo as operating costs**

**Arm’s length transactions at fair value**
- Price at which TVCo sells advertising space to others is similar to that charged to NewsCo
- **Indicator suggests transactions are independent i.e. NewsCo would present payments to TVCo as operating costs**

**Settlement of cash flows**
- Cash flows for the respective advertising sales are settled separately
- **Indicator suggests transactions are independent i.e. NewsCo would present payments to TVCo as operating costs**
Example 2: Physical slotting fees

Scenario

Book publisher PublishCo sells books to BookStoreCo on a sale-or-return basis. In order to maximise sales of its (potential) bestsellers to actual readers, PublishCo occasionally pays 'slotting fees' to BookStoreCo in exchange for prominent book displays and other in-store marketing.

The book sales contracts and the in-store marketing (slotting fee) contracts are independent contracts that are signed at different times and make no reference to each other. However, any individual slotting fee that is agreed between the parties under the overarching contract is paid with reference to a particular book that BookStoreCo will market. Slotting fees are usually settled by netting them off against revenues receivable from BookStoreCo, as part of the overall net settlements of shipments, returns and open invoices.

BookStoreCo receives similar slotting fees from most of its major publishers.

How should PublishCo account for its slotting fee payments to BookStoreCo?

PublishCo must assess whether its payments to BookStoreCo for in-store marketing:

- represent consideration for a marketing service that has been purchased independently of book sales to BookStoreCo, in which case PublishCo would most likely regard the payments as marketing and present them as operating costs in its income statement; or
- are directly linked to book sales to BookStoreCo, in which case PublishCo would treat the payments as discounts and offset them against revenue.

Assessment of key indicators

An indicative assessment by PublishCo for the key indicators might be:

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Assessment by book publisher PublishCo</th>
</tr>
</thead>
</table>
| Obligation to purchase the product or service from customer (i.e. from BookStoreCo) | • There are no indications that BookStoreCo obliges PublishCo to buy book displays and in-store marketing  
• However, there may be an implicit expectation that major publishers will spend a certain amount on slotting fees each year; and in any case, PublishCo will be aware that if it does not secure prominent displays then its potential bestsellers will underperform  
• Indicator suggests there may be some implicit obligation or expectation for PublishCo to purchase in-store marketing from BookStoreCo i.e. PublishCo would present payments as deductions from revenue |
**Indicators**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Assessment by book publisher PublishCo</th>
</tr>
</thead>
</table>
| **Independent contracts at different times with no reference to each other** | - Contracts are signed separately and make no reference to each other and have independent pricing arrangements  
- However, each slotting fee paid relates to a specific book that has been sold by PublishCo to BookStoreCo  
- **Indicator is mixed since the independent pricing in the separate book sales and slotting contracts suggests transactions are independent; but they relate to the same title which suggests they are linked** |
| **Customer (BookStoreCo) selling same product or service to other third parties** | - BookStoreCo receives similar slotting fees from most of its major publishers  
- However, these are (by definition) all publishers that are also major suppliers to BookStoreCo, making it difficult to argue that slotting fees are sold independently  
- **Indicator suggests slotting fees are not independent of book sales i.e. PublishCo would present payments as deductions from revenue** |
| **Arm’s length transactions at fair value** | - Price at which BookStoreCo sells in-store marketing to other publishers is similar to PublishCo  
- However, all these publishers are major suppliers to BookStoreCo, making an independent assessment of the fair value of slotting fees challenging, since they only occur where significant book sales also take place  
- An attempt could be made to infer the value of slotting fees by comparing the book price between those instances where publishers do and do not pay slotting fees, but since most major publishers will pay slotting fees for their major titles, this is also challenging  
- In absence of clear evidence to support fair value, the conclusion is likely to be that the transactions are inextricably linked  
- **Indicator suggests slotting fees are not independent of book sales i.e. PublishCo would present payments as deductions from revenue** |
| **Settlement of cash flows** | - Cash flows for slotting fees are settled as part of overall net settlement of book shipments, returns and open invoices  
- **Indicator suggests slotting fees are not independent of book sales i.e. PublishCo would present payments as deductions from revenue** |

**Conclusions**

In summary, although the book sales and in-store marketing contracts are legally separate, the balance of indicators suggests that slotting fees are in substance not independent of books sales to BookStoreCo. That is, if PublishCo had not entered into a sales transaction with BookStoreCo (i.e. sold books) in the first place, it would not have paid for marketing services. Accordingly, no separately identifiable service has been purchased and PublishCo would present the payments as deductions against revenue (not as separate marketing costs).

However, if some of the facts and circumstances were varied, the determination could be different. For example, in the (unlikely?) event that BookStoreCo also sold in-store marketing services to non-publishers, it might be that fair value could be established for the slotting fees. This might swing the balance of indicators in favour of presenting the slotting fees as operating costs in PublishCo’s income statement.
Example 3: Digital slotting fees

Scenario

TVCo operates a suite of channels that it makes available to cable company TVDistributor in exchange for channel revenues. The channel revenues paid by TVDistributor are a combination of fixed fee and a variable element driven by audience figures for TVCo’s channels.

As part of a contract renegotiation, TVCo extends this distribution deal by five years and also makes a one-time up-front payment to TVDistributor to improve its position on the Electronic Programme Guide (EPG) from the eighth page to the first page. TV channels on the first couple of pages typically have significantly higher viewing figures, in part because most ‘channel-hopping’ viewers select relatively early from the EPG so do not get to the later pages.

TVCo’s improved EPG position – its new ‘slot’ – will enable TVCo to secure higher audience revenues from TVDistributor and also higher rates from its advertisers. It will last for five years, concurrent with the renewed distribution deal. If the distribution deal is cancelled for any reason during these five years then a pro-rated portion of the EPG payment will be refunded by TVDistributor to TVCo.

How should TVCo account for the EPG payment?

Since TVCo’s EPG payment gives rise to an identifiable benefit over the next five years of the renewed television distribution agreement, it seems reasonable that this cost should be deferred over five years rather than immediately recognised in full in the income statement when the distribution and EPG agreements are signed.

However, the income statement presentation as the payment unwinds over five years must be addressed. TVCo must assess whether the payment to TVDistributor to improve its EPG position:

- represents a marketing payment that is independent of receiving channel revenues from TVDistributor, in which case the EPG payment would be presented in the income statement as an operating cost (i.e. amortisation of an ‘EPG position’ intangible asset); or
- is a transaction that is directly linked to receiving channel revenues from TVDistributor, in which case the EPG payment would be treated as a deduction from revenue (i.e. unwind of an advance deposit paid against future television channel revenues).
Conclusions

In summary, although the distribution arrangement and EPG contracts are legally separate, they were signed simultaneously and are clearly linked through their concurrent five year time period and the pro-rated refund of the EPG payment if the distribution deal is cancelled. Moreover, establishment of independent fair value for the EPG payment would be challenging. Accordingly, the balance of indicators suggests the EPG payment by TVCo is in substance not independent of the television distribution arrangement, so TVCo would present the EPG payment as an offsetting deduction against revenue over the five-year term of the contract (not as intangible amortisation).

However, if some of the facts and circumstances were varied, the determination could be different. For example, in the event that television content companies had all already paid for identical fixed term distribution arrangements, then a separate auction of EPG slots open to all content companies might be deemed a separate service with separable fair value. This might swing the balance of indicators in favour of presenting the EPG payment as an operating cost in TVCo’s income statement.

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*Assessment of key indicators*

An indicative assessment by TVCo for the key indicators might be:

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Assessment by television company TVCo</th>
</tr>
</thead>
</table>
| Obligation to purchase the product or service from customer (i.e. from TVDistributor) | • There is no suggestion that TVDistributor obliged TVCo to pay for the improved EPG position as part of the renewed television distribution deal  
• Indeed, since there are many more cable channels than there are desirable EPG positions, TVDistributor is likely to be selling them to the highest bidder rather than forcing a specific channel to take them  
• **Indicator suggests transactions are independent i.e. TVCo would present EPG payment as intangible amortisation within operating costs** |
| Independent contracts at different times with no reference to each other | • Contracts were signed at the same time and last for the same period (five years)  
• Moreover, EPG payment is refundable (on pro-rated basis) if the distribution deal is cancelled  
• **Indicator suggests transactions are linked i.e. TVCo would present EPG payment as a deduction from revenue** |
| Customer (TVDistributor) selling same product or service to other third parties | • TVDistributor occasionally auctions desirable EPG positions among those channels whose content it broadcasts  
• This happens relatively infrequently since continual changes within the EPG would confuse and upset viewers  
• All television companies that bid for EPG positions are either already being distributed by TVDistributor or in the process of negotiating such a deal. This make it difficult to argue that desirable EPG positions are sold independently  
• **Indicator suggests transactions are linked i.e. TVCo would present EPG payment as a deduction from revenue** |
| Arm’s length transactions at fair value | • Price at which TVDistributor sold the desirable EPG position to TVCo could in theory be compared to similar arrangements with other television content providers  
• However, all these television companies are major suppliers to TVDistributor, making an independent assessment of the fair value of the EPG payment challenging  
• In this scenario any attempt to separately fair value the EPG payment from distribution revenues is further complicated by the fact the distribution deal was negotiated simultaneously with the EPG payment  
• In absence of clear evidence to support fair value, the conclusion is likely to be that the transactions are inextricably linked  
• **Indicator suggests transactions are linked i.e. TVCo would present EPG payment as a deduction from revenue** |
| Settlement of cash flows | • The EPG payment is made separately (up front) rather than netted off against distribution revenues  
• **Indicator suggests transactions are independent i.e. TVCo would present EPG payment as intangible amortisation within operating costs** |
Example 4: Outsourcing advertising sales

Scenario

RadioCo has previously maintained its own in-house advertising sales function. RadioCo has now decided this sales function is non-core so is outsourcing its advertising sales to AdSalesCo.

Under the outsourcing agreement RadioCo appoints AdSalesCo to be the exclusive seller of advertising space (‘spots’) across all RadioCo’s radio stations. RadioCo’s previous in-house ad sales team is transitioned across to AdSalesCo.

AdSalesCo is now responsible for selling advertising spots to third party advertisers. It pays ‘audience revenues’ to RadioCo based on the size of audience (i.e. number of listeners) delivered by RadioCo’s stations. The audience revenues are calculated with reference to the number of listeners, not with reference to the advertising revenue actually generated by AdSalesCo. AdSalesCo is free to price the advertising as it sees fit and bundle it with advertising on other radio channels or other media. Under the new arrangement, RadioCo is effectively a seller of audiences (to AdSalesCo) rather than a seller of advertising spots (to third party advertisers).

As part of the arrangement, RadioCo pays to AdSalesCo an annual fixed fee for the service of selling the advertising spots on its behalf. This fixed fee is broadly equivalent to the fixed salary costs of the ad sales team that transitioned from RadioCo to AdSalesCo. The cash flows for the fixed fee and audience revenues are settled separately.

How should RadioCo account for the fixed fee paid to AdSalesCo?

RadioCo must assess whether the fixed fee paid to AdSalesCo represents:

- consideration paid to AdSalesCo for selling advertising on its behalf, in which case the flat fee would be presented in the income statement as a cost; or
- a transaction that is directly linked to receiving audience revenues from AdSalesCo, in which case the fixed fee would be treated as a deduction from revenue.

Assessment of key indicators

An indicative assessment by RadioCo for the key indicators might be:

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Assessment by radio company RadioCo</th>
</tr>
</thead>
</table>
| Obligation to purchase the product or service from customer (i.e. from AdSalesCo) | • RadioCo is obliged to pay the fixed fee as part of the arrangement to outsource advertising sales to AdSalesCo  
  • Indicator suggests transactions are linked i.e. RadioCo would present the fixed fee paid to AdSalesCo as a deduction from revenue |
| Independent contracts at different times with no reference to each other | • The fixed fee is embedded within a single advertising sales outsourcing contract  
  • Indicator suggests transactions are linked i.e. RadioCo would present the fixed fee paid to AdSalesCo as a deduction from revenue |
**Indicator**

<table>
<thead>
<tr>
<th>Assessment by radio company RadioCo</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customer (AdSalesCo) selling same product or service to other third parties</strong></td>
</tr>
<tr>
<td>AdSalesCo offers outsourcing of advertising sales to a variety of content owners</td>
</tr>
<tr>
<td>In each case, there will either be a fixed fee payable with higher audience revenues; or no fixed fee but lower audience revenues. It would be illogical for AdSalesCo not to adjust the audience rate to compensate for the presence or absence of the fixed fee</td>
</tr>
<tr>
<td>The fixed fee is therefore payable only by add (some of) the media companies that have outsourced the selling of advertising</td>
</tr>
<tr>
<td><strong>Indicator suggests transactions are linked i.e. RadioCo would present the fixed fee paid to AdSalesCo as a deduction from revenue</strong></td>
</tr>
<tr>
<td><strong>Arm’s length transactions at fair value</strong></td>
</tr>
<tr>
<td>An indicative pricing basis could be established for the fixed fee since it is deliberately structured to cover the known fixed salary costs of the transitioned advertising sales team</td>
</tr>
<tr>
<td>Pricing could also be established for the audience revenues since this will similarly be based on RadioCo’s advertising sales prior to transition to AdSalesCo</td>
</tr>
<tr>
<td>However, these are only calculation mechanisms to support the pricing negotiations – since the fixed fee would never be paid other than in such an outsourcing arrangement, separable fair value (in an accounting sense) cannot be established</td>
</tr>
<tr>
<td>In absence of clear evidence to support fair value, it is likely that the pricing of the two elements are inextricably linked</td>
</tr>
<tr>
<td><strong>Indicator suggests transactions are linked i.e. RadioCo would present the fixed fee paid to AdSalesCo as a deduction from revenue</strong></td>
</tr>
<tr>
<td><strong>Settlement of cash flows</strong></td>
</tr>
<tr>
<td>The fixed fee is paid separately by RadioCo rather than being netted against the audience revenues receivable from AdSalesCo</td>
</tr>
<tr>
<td><strong>Indicator suggests transactions are independent i.e. RadioCo would present the fixed fee paid to AdSalesCo as an operating cost</strong></td>
</tr>
</tbody>
</table>

**Conclusions**

In summary, although there is a basis for the calculation of the fixed fee and it is paid separately from audience revenues received, it is clearly and inextricably part of one overall advertising outsourcing contract. Accordingly, the balance of indicators suggests that the fixed fee is not independent of audience revenues so RadioCo would most likely present the fixed fee as an offsetting deduction against revenue (not as a separate operating cost).

This can lead to some interesting outcomes when comparing periods. Pre-outsourcing, RadioCo effectively presented 100% of its advertising revenues gross with the fixed base salary costs of its sales team in operating costs; post-outsourcing, these items are netted off. The outsourcing arrangement therefore decreases RadioCo’s revenues but increases its percentage profit margin.

Furthermore, if some of the facts and circumstances were changed, the determination could be different. For example, if the fee paid by RadioCo varied directly in proportion to the advertising sales actually achieved by AdSalesCo, and AdSalesCo was given less discretion over pricing and the bundling of RadioCo’s advertising with other advertising, it would be more likely that AdSalesCo was deemed to be acting as an advertising sales agent and the fee paid to AdSalesCo would be a commission expense in RadioCo’s income statement.
Example 5: Video game prizes

Scenario

VideoGameCo operates large multi-player internet based video games. Each of the many thousands of participating gamers must pay an up-front fixed fee to enter. The game typically lasts two months and at the end one winning gamer receives a large cash prize that is many times larger than that gamer’s entry fee. The prize will definitely be paid to one gamer.

Given the odds against winning, it is generally assumed that the thousands of gamers pay to enter for the fun of taking part, not in expectation of being the eventual winner.

How should VideoGameCo account for the cash prize?

VideoGameCo must assess whether its cash prize to the winning gamer:

- represents a marketing expense that is paid independently to generate the sales of the individual entry fees from each game; or
- is a transaction directly linked to the collective entry fees received from all gamers, in which case VideoGameCo would most likely treat the prize as an offsetting deduction against revenue.

Assessment of key indicators

An indicative assessment by VideoGameCo for the key indicators might be:

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Assessment by internet video game operator VideoGameCo</th>
</tr>
</thead>
</table>
| Obligation to purchase the product or service from customer (i.e. to pay the prize to winning gamer) | • VideoGameCo was not obliged to offer a prize to entice gamers to sign up, but presumably deems this a key part of its marketing to raise the game’s profile, even though each gamer is aware their personal odds of victory are very low  
• Once the decision to offer a prize is taken, it is embedded within the terms and conditions of the entry fee i.e. once the game ends, VideoGameCo will be obliged to pay the prize to the winning gamer  
• Indicator suggests that VideoGameCo is obliged to make this payment to one of its customers under the terms and conditions of the entry fee, so transactions are linked i.e. VideoGameCo would present the prize paid to winning gamer as a deduction from revenue |
| Independent contracts at different times with no reference to each other | • The prize is embedded within the terms and conditions of the entry fee  
• Indicator suggests transactions are linked i.e. VideoGameCo would present the prize paid to winning gamer as a deduction from revenue |
### Indicator Assessment by internet video game operator VideoGameCo

| Customer (gamer) selling same product or service to other third parties | • If VideoGameCo were to identify this payment as an expense, it would be for a marketing service  
• The gamers do not provide a service, although it might be argued that the offer of the prize results in more customers for VideoGameCo. But a marketing expense must be separable from the revenues that it is designed to generate, whereas this prize and entry fees are directly linked  
• **Indicator suggests transactions are linked** i.e. VideoGameCo would present the prize paid to winning gamer as a deduction from revenue |
|-------------------------|-------------------------------------------------------------------------------------------------------------|
| Arm’s length transactions at fair value | • Prices could be compared to other online multi-player video games to establish whether the offer of the prize has the effect of raising the entry fee that can be charged  
• The general assumption that gamers enter for the joy of playing might also support a conclusion that the prize is for marketing purposes rather than as a direct incentive that impacts the entry fee gamers are willing to pay  
• However, each video game is unique, with differing pricing model and levels; and moreover this specific game is only offered with the prize embedded, meaning that separable fair value (in an accounting sense) is difficult to establish  
• In absence of clear evidence to support fair value, the conclusion is likely to be that the transactions are inextricably linked  
• **Indicator suggests transactions are linked** i.e. VideoGameCo would present the prize paid to winning gamer as a deduction from revenue |
| Settlement of cash flows | • The entry fee is paid up front and the prize is paid after the game ends  
• **Indicator suggests transactions are independent** i.e. VideoGameCo would present the prize paid to winning gamer as an operating cost |

### Conclusions

In summary, while it seems clear that VideoGameCo offers the prize to generate sales, the payment is not made to a provider of marketing services or independently of the entry fees paid by gamers. The payment is contingent on making sales – that is, if no-one enters the game, VideoGameCo does not receive the cash needed for the prize payment.

As such, while the prize is many times larger than the entry fee that each individual gamer pays, there is no separate service received by VideoGameCo. Accordingly, the most likely presentation of the prize in VideoGameCo’s income statement is as a deduction from revenue.

It is worth highlighting that if fewer gamers enter than are necessary to generate revenue at least equal to the committed prize money, VideoGameCo would need to recognise an onerous contract provision for the difference, which would be presented as an expense.
Conclusion

Payments to customers can present accounting challenges in many sectors, but particularly in a fast-evolving media and technology landscape where two companies are frequently both supplier to, and customer of, each other. A media company’s assessment of whether payments to its customers are independent or directly linked to sales transactions determines whether the company recognises these payments as costs or deductions from revenue. This in turn affects two key metrics in opposite directions: revenue and percentage profit margin.

This paper has considered the assessment of payments to customers in various practical examples, covering the purchase of advertising space, physical and digital ‘slotting fees’, outsourced advertising sales and video game prizes.

The scenarios in this paper are clearly not designed to be exhaustive; but they will hopefully provide food for thought for media companies when considering how to account for payments to their customers. The answer for complicated real life arrangements will depend on the specific facts and circumstances in each case. Where transactions are significant, management should include disclosures in the financial statements that enable users to understand the conclusions reached. As always, planning ahead can prevent painful surprises.

We hope you found this paper useful and welcome your feedback.

To comment on any of the issues highlighted in this paper please visit our dedicated website www.pwc.com/miag or contact your local PwC entertainment and media specialist.
This paper explores some of the accounting complexities related to joint ventures which can arise for media companies both under existing IFRS and in the future.

Media Industry Accounting group
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This paper explores the critical considerations relating to the classification, capitalisation and amortisation of content development spend under the applicable IFRS standards IAS 2 Inventories and IAS 38 Intangible Assets, focusing on the television production, educational publishing and video game sectors.

Revenue recognition: principal/agent arrangements – issues for media companies

This paper considers the assessment of the key principal/agent considerations in various practical examples, covering physical books, eBooks, television content and film production.
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