

In depth

A look at current financial reporting issues



No. US2017-19
August 25, 2017

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New revenue guidance Implementation in entertainment and media

At a glance

Public companies must adopt the new revenue standards in 2018. Almost all companies will be affected to some extent by the new guidance, though the effect will vary depending on industry and current accounting practices. Although originally issued as a converged standard under US GAAP and IFRS, the FASB and IASB have made slightly different amendments so the ultimate application of the guidance could differ under US GAAP and IFRS.

The Revenue Recognition Transition Resource Group (TRG) has discussed various implementation issues impacting companies across many industries. These discussions may provide helpful insight into application of the guidance, and the SEC expects registrants to consider these discussions in applying the new guidance.

This publication reflects the implementation developments since the standards were issued and highlights certain challenges specific to companies in the entertainment and media industry. The content in this publication should be considered together with our [Revenue guide](#), available at [CFODirect.com](#).

Overview

The entertainment and media (E&M) industry comprises a diverse set of subsectors, including filmed entertainment, television and cable broadcast, data services, advertising, music, video games and publishing. This publication explores the effects of the new revenue standards (ASC 606 and IFRS 15, *Revenue from Contracts with Customers*) on these subsectors, and contrasts it with current practice under US GAAP and IFRS. The examples and related discussions are intended to highlight areas of focus to assist companies in evaluating the implications of the new standards. However, the new revenue standards are principles-based, requiring the application of significant judgment and consideration of specific facts and circumstances.

Scope

The standards apply to all contracts with customers, excluding leases, financial instruments, and certain guarantees and arrangements in the scope of other guidance. As such, it is important to identify whether the counterparty to the arrangement is a customer. The standards define a customer as “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.” The analysis may be straightforward in many instances, but in other situations, it will be more complicated to confirm whether a customer relationship exists.

For instance, E&M companies need to evaluate their collaborative arrangements to determine if those arrangements are contracts with customers and thus in the scope of the standards. A contract outside the scope of the standards is one in which a collaborator or partner shares in the risk of developing a good, rather than obtaining an output of the company’s ordinary activities. For example, a film studio may enter into an arrangement with a counterparty (such as another production company) to co-develop a film for international distribution. Such an arrangement may not be in the scope of the revenue standards if the parties share the risk of developing the film. Alternatively, it likely is in scope if the substance of the arrangement is that the studio is licensing its film to the counterparty or providing production services.

Licenses

Licenses in the E&M industry take a variety of forms, such as a license to a music catalogue, data, rights to a syndicated television show, or to utilize an animated character’s image.

Current US GAAP provides E&M industry-specific guidance for license transactions not only with respect to the timing of recognition, but also with respect to various other concepts, such as the treatment of cross-collateralized film deals, music licenses for new and library content, contingent royalties, the fair value of software related deliverables and film license modifications. The new standards supersede this industry-specific guidance. As such, a company will generally need to apply the other steps of the standards (1. identify the contract, 2. identify performance obligations, 3. determine the transaction price, and 4. allocate the price to separate performance obligations) to determine how to recognize revenue for its license arrangements, just as it would for non-license arrangements. Removal of the industry specific guidance on licenses and use of the new model will result in a change to the timing of recognition of revenue in some cases.

The license model recognizes revenue from certain licenses at a point in time and others over time; however, the guidance for evaluating the nature of the promise in granting a license of intellectual property (IP) differs between ASC 606 and IFRS 15.

New guidance	Current US GAAP	Current IFRS
<p><i>US GAAP</i></p> <p>Under ASC 606, IP that is licensed to a customer is classified as either “functional IP” (e.g., music, film, software or completed media content) or “symbolic IP” (e.g., brand names or logos).</p> <p>IP is considered functional if it has significant standalone functionality (e.g., it can process a transaction, perform a function or task, or be played/aired). A license is considered symbolic IP if it is not functional.</p> <p>Licenses of symbolic IP, which represent a right to access the IP,</p>	<p>Industry-specific guidance exists with respect to certain forms of IP licenses.</p> <p>For film licenses (including episodic television), revenue is recorded when:</p> <ul style="list-style-type: none"> • there is persuasive evidence of an arrangement; • the IP is complete and has been delivered; • the license period began and the customer can begin using the IP • the fee is fixed or determinable; and • collection is reasonably assured. 	<p>IFRS does not contain any industry-specific accounting for E&M companies. In general, revenue is not recognized under licensing arrangements until performance under the contract has occurred and the revenue has been earned.</p> <p>The assignment of rights for a nonrefundable amount under a noncancellable contract permits the licensee to use those rights freely. The transaction is, in substance, a sale when the licensor has no remaining obligations to perform.</p> <p>A fixed license term is an indicator that the revenue should be recognized over the period because the fixed term suggests that the</p>

New guidance	Current US GAAP	Current IFRS
<p>are performance obligations satisfied over time.</p> <p>Functional IP licenses are performance obligations satisfied at a point in time as a right to use license unless both of the following criteria are met:</p> <ul style="list-style-type: none"> the functionality of the IP is expected to substantively change as a result of activities of the company that do not transfer a good or service to the customer and the customer is contractually or practically required to use the updated IP. <p>IFRS</p> <p>Under IFRS 15, determining whether a company’s promise to grant a license provides a customer with either a right to access IP or a right to use IP depends on whether a customer can 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.</p> <p>The nature of a company’s promise in granting a license is a promise to provide a right to access IP if all of the following criteria are met:</p> <ul style="list-style-type: none"> the contract requires, or the customer reasonably expects, that the company will undertake activities that significantly affect the intellectual property to which the customer has rights; the rights granted by the license directly expose the customer to any positive or negative effects of the company’s activities; and those activities do not result in the transfer of a good or a service to the customer as those activities occur 	<p>For music licenses, revenue may be recognized at a point in time when:</p> <ul style="list-style-type: none"> there is a noncancellable contract; a fixed fee; the music right and recording has been delivered; and there are no remaining significant obligations to furnish additional music. <p>If these criteria are not met, revenue should be recognized over the remaining performance or license period.</p> <p>For software licenses (e.g., video games), specific guidance exists to determine whether the revenue recognition criteria have been achieved (e.g., persuasive evidence of an arrangement). Additionally, multiple element arrangements that include the licensing of software also require the existence of vendor-specific objective evidence (VSOE) of fair value to separate the software deliverables from other deliverables in the arrangement, such as post contract customer support (or PCS).</p> <p>For other forms of licensing, there is no industry-specific guidance, so general revenue recognition guidance applies. Companies must determine whether a point-in-time or over-time model is more appropriate.</p>	<p>license’s risks and rewards have not been transferred to the customer. However, the following indicators should be considered in determining whether a license fee should be recognized over the term or upfront:</p> <ul style="list-style-type: none"> fixed or non-refundable guarantee contract is noncancellable customer is able to exploit the rights freely; and the vendor has no remaining performance obligations.

New guidance	Current US GAAP	Current IFRS
<p>All other licenses are treated as a right to use.</p> <p>We expect that the outcome of applying the two standards will be similar; however, there will be fact patterns for which outcomes could differ.</p> <p>Impact of license restrictions:</p> <p>Many licenses within the E&M industry include provisions that specify the licensee’s rights with respect to the use of the IP (e.g., use for a specified term or in a specified geography). The new revenue guidance requires companies to distinguish between (1) contractual provisions that define the attributes of a license of IP and (2) provisions that represent additional promised goods or services to the customer.</p> <p>Contractual provisions that are attributes of a single promised license define the scope of a customer’s rights to IP and do not affect the number of performance obligations or whether a performance obligation is satisfied at a point in time or over time.</p> <p>ASC 606 and IFRS 15 use different words to explain how contractual restrictions may impact the number of promises in a contract. The FASB included additional examples related to license restrictions. We believe the concepts in the two standards are similar; however, companies may reach different conclusions under the two standards given that ASC 606 contains more specific guidance.</p>		

Potential impact

Sectors in Entertainment and Media most impacted

Film and TV production	TV and cable broadcasting	Information services & data	Advertising	Music	Publishing	Video games
√	√	√		√	√	√

The nature of a company’s promise in granting a license

The accounting for licenses under the new standards have the potential to affect many E&M companies that previously followed industry-specific revenue guidance in US GAAP. Although IFRS does not include industry-specific guidance, application of the new guidance may result in changes relative to existing IFRS.

A company must first establish whether a license is distinct from other goods and services in the arrangement before determining the pattern of revenue recognition for the license. In some cases, the identification of distinct licenses may be challenging, especially when trying to differentiate between contractual provisions that (1) define the attributes of a single promised license and (2) those that transfer control of additional rights to the customer.

The revenue standards include specific implementation guidance for accounting for licenses of IP. The overall framework is similar, but there are some differences between US GAAP and IFRS. In particular, there is different guidance for evaluating whether a license is a right to access IP or a right to use IP.

Under US GAAP, common examples of functional IP and symbolic IP in the E&M industry include licenses of the following:

Functional IP	Symbolic IP
<ul style="list-style-type: none">• Media and information-based software• Content licensing arrangements for the publishing subsector• Data files with periodic updates• Completed media content including:<ul style="list-style-type: none">○ Music○ Rights to exhibit a movie upon theatrical release○ Rights to air an episodic or syndicated television show	<ul style="list-style-type: none">• Character images• Brands• Logos• Team names• Franchise rights

Under IFRS, the determination of whether a promise to grant a license provides a right to access IP or a right to use IP is based on whether the IP is significantly affected by the company’s activities.

Revenue related to certain types of licenses may be accelerated, whereas others could be deferred compared to the current treatment. For example, licenses of symbolic IP such as franchise rights, which may have been recognized at a point in time under existing guidance, will now be recognized over time. Further, under US GAAP and IFRS, functional IP related to software and media content may now be recognized at a point in time.

Example 1: License of a sports team brand

Facts: Licensor licenses the brand name of a defunct sports team (e.g., Brooklyn Dodgers) to use in its production of memorabilia.

What is the nature of the brand name license?

Analysis: The license is symbolic IP. Under US GAAP the company determines that the licensed IP (the brand name) is symbolic because it has no standalone functionality (e.g., the brand name cannot process a transaction, perform a function or task). As a result, revenue would be recognized over time.

In contrast, under IFRS, the licensor may recognize revenue at a point in time if the licensor will no longer undertake activities that significantly affect the IP (i.e., the brand name).

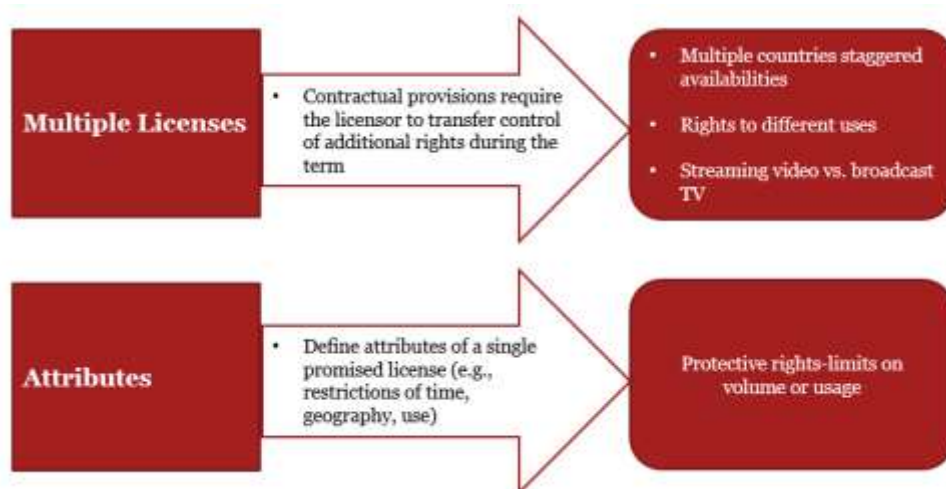
Contractual restrictions in license arrangements

Many licenses within the E&M industry include contractual provisions that restrict the licensee's use of the IP. For example, a license to a film for a two-year period may contain a contractual provision that prohibits the licensee from running the film more than five times over that two-year period. Judgment is required in determining whether contractual restrictions of time, geography, or use:

- (1) affect the number of promised goods or services in a contract; or
- (2) define attributes of a single promised license.

Licenses

Contractual restrictions



ASC 606 and IFRS 15 use different terminology to explain these concepts. ASC 606 also includes additional examples (Examples 61A and 61B) of license restrictions and their accounting impact. We believe the concepts in the standards are similar; however, companies may reach different conclusions under the standards given that ASC 606 contains more detailed guidance. IFRS 15 requires a company to determine whether the additional rights are an attribute of the license and if not, to apply the guidance for identifying performance obligations. Significant judgment will be required to assess whether a contractual provision in a license creates an obligation to transfer multiple licenses (and therefore separate performance obligations) or whether the provision is a restriction that represents an attribute of a single license.

The following examples illustrate the impact of restrictions in a license to IP.

Example 2: License restrictions – restrictions are an attribute of the license

Facts: A studio licenses rights that permit a cable channel to exhibit a film up to five times during a two-year term.

What is the impact of the contractual provisions that restrict the use of IP in this arrangement?

Analysis: Since the licensor transfers control of all the licensed rights at inception, the contractual restrictions in this arrangement are considered attributes of the license. Such restrictions are not indicative of multiple performance obligations.

In contrast, if the studio licensed five separate films to be exhibited over the same two-year period, but the films were not all available at inception, the transfer of the rights to each film would likely be separate performance obligations. A company would need to evaluate each performance obligation separately to assess the timing of recognition. License revenue should not be recognized until the licensee can benefit from the rights that have been transferred.

Example 3: License restrictions - distinguishing multiple licenses from attributes of a single license

Facts: Producer licenses to Cable Co. the right to broadcast a television series domestically for years 1-3 (January 1, 20X0- December 31, 20X2) for an upfront license fee. For years 4 and 5 (January 1, 20X3- December 31, 20X4), Cable Co. is provided with the right to broadcast the television series internationally.

What is the impact of the contractual provisions that restrict the use of IP in this arrangement?

Analysis: Producer determines, based on analyzing the specific provisions of the arrangement, its promise is to deliver multiple licenses, including a domestic license and an international license, as the arrangement requires Producer to transfer control of additional rights (right to broadcast internationally) to Cable Co. at the beginning of year 4.

Producer should allocate the transaction price (i.e., the upfront fee) to the two separate performance obligations because it has concluded that there are two distinct licenses. The allocation should be based on relative standalone selling prices, and revenue should be recognized when the customer has the ability to use and benefit from its right to use the IP. The revenue allocated to the license to use the IP domestically would be recognized on January 1, 20X0. The revenue allocated to the license to use the IP internationally would be recognized on January 1, 20X3.

Each license would be recognized at a point in time as the television series represents functional IP under US GAAP. Under IFRS, each license would be recognized at a point in time assuming Producer does not undertake activities that significantly affect the IP.

Modifications

Contract modifications are accounted for as either a separate contract or as part of the existing contract (either prospectively or through a cumulative catch-up adjustment). This assessment is driven by whether (1) the modification adds distinct goods and services and (2) the additional goods and services are priced at their standalone selling prices.

Renewals/extensions

Renewals or extensions of the license rights are common in various E&M subsectors in which the licensee pays consideration for the right to use IP for an additional time period. In many instances, the IP is already available to the licensee at the time the licensee decides to renew the license. This raises a question as to when revenue should be recognized for the renewal period.

US GAAP specifies that revenue from the renewal or extension of a license cannot be recognized until the customer can use or benefit from the license renewal (that is, at the beginning of the renewal period). This is true even if the licensor provides a copy of the IP in advance of the renewal period or the customer has a copy of the IP from another transaction.

IFRS does not include specific guidance on license renewals. Companies applying IFRS should evaluate whether a renewal or extension should be accounted for as a new license or a modification of an existing license or whether the existence of renewal option implies that the initial contract has a longer term. This may result in some cases of recognition of revenue from renewals earlier under IFRS compared to US GAAP. See chapter 9 of PwC's [Revenue guide](#) for further guidance.

Example 4: License modifications/extensions

Facts: Assume the same facts as in Example 3, but after year 4, Cable Co. pays a fee to renew both licenses for an additional two years commencing after year 5.

When should Producer recognize revenue for the renewal?

Analysis: Producer should not recognize revenue arising from the extension prior to year 6 because Cable Co. cannot use and benefit from the license before the beginning of year 6 consistent with TRG Memo No.45, *Specific Application Issues About Restrictions and Renewals*. That paper indicates that revenue cannot be recognized for a renewal before the renewal period begins.

The renewal is a form of modification in that the parties have extended the contract, and Producer should apply the contract modification guidance in the new revenue standards to modifications that grant additional distinct licenses in the same manner that one would apply that guidance to any other modification that adds additional distinct goods

or services. Producer should evaluate whether the renewal should be treated as a new license or the modification of an existing license. In this scenario, it is likely that the Producer would conclude that the renewal is distinct under US GAAP and possibly also under IFRS. If the price for the renewal reflects its standalone selling price, Producer will account for the renewal as a separate contract with Cable Co. Alternatively, if the price for the renewal does not reflect the standalone selling price of the renewal, Producer will account for the renewal as a modification of the original license contract.

Sales- or usage-based royalties on licenses of IP

The FASB and IASB decided on an exception relating to variable consideration for sales- or usage-based royalties of licensed IP. Under this exception, revenue related to a sales- or usage-based royalty cannot be recognized until the actual sale or usage occurs and the performance obligation to which it has been allocated has been satisfied (or partially satisfied). This means that, in many cases, the accounting treatment of contingent royalty transactions will remain consistent with current practice under both US GAAP and IFRS. When actual sales or usage data is not available at the end of reporting period, E&M companies will need to use judgment to estimate the royalties for that period. Additionally, when applying this exception to an arrangement, it is not appropriate to recognize revenue in the period that the sales or usages are reported by the customer (i.e., recognize on a “lag” basis). As a result, it may be necessary to estimate sales or usages.

Sales- or usage-based royalties on two or more promises

Additional complexity arises when a license of IP is bundled with other goods and services. For example, assume a company licenses IP and also sells goods to the customer in the same contract. The fee structure is in the form of a revenue sharing arrangement entitling the licensee to a percentage of sales related to both the goods sold and the license. The new standards stipulate that in such circumstances, the royalty exception should only be applied when the sole or predominant item to which the royalty relates is a license of IP. Otherwise, the licensor would apply the general variable consideration guidance to estimate the transaction price and allocate the transaction price between the license and the other goods or services.

Although the FASB and IASB did not provide a specific definition of “predominant,” the standards note that if a customer would ascribe significantly more value to the license component, it would likely be predominant. Judgment will be required to determine whether the predominant item to which a royalty relates is the license component.

Minimum guarantees

Minimum guarantees are common in the E&M industry and are often used in license arrangements in which the consideration is in the form of a sales- or usage-based royalty. In some cases, the minimum guarantee is negotiated due to uncertainty about the customer’s performance and its ability to successfully exploit the intellectual property. In other cases, the minimum guarantee is established as a cash flow management tool to provide the licensor with predictable timing of some of the cash flows under the contract. Questions are arising in practice when determining whether and how the guaranteed minimum impacts the application of the recognition constraint for sales- or usage-based royalties for licenses of intellectual property.

At the November 2016 TRG meeting, the TRG noted that, for functional IP, a minimum royalty guarantee is fixed consideration and should be recognized when the licensor transfers control of the IP to the licensee. The variable consideration (i.e., the amount above the fixed minimum) should be recognized in accordance with the sales- or usage-based royalty exception.

For licenses in which revenue is recognized over time (i.e., symbolic IP), the TRG discussed three acceptable approaches when applying the sales- or usage-based exception for licenses of symbolic IP that include a minimum guarantee:

- Recognize revenue as the royalties occur if the licensor expects the total royalties to exceed the minimum guarantee.
- Estimate the total transaction price (including fixed and variable consideration) that will be earned over the term of the license. Using an appropriate measure of progress, recognize revenue subject to the royalty constraint.
- Recognize the minimum guarantee (fixed consideration) using an appropriate measure of progress, and recognize royalties only when cumulative royalties exceed the minimum guarantee. Since the new revenue standards do not prescribe a single approach, judgment must be applied when selecting a methodology used to measure progress. We believe any of the three views are reasonable, although companies should select the method that best depicts the transfer of goods and services to customers. Companies should also consider the

nature of their arrangements and ensure that the measure of progress does not conflict with the core principles of the new revenue standards, such as the royalty constraint or allocation principle. Companies should also appropriately disclose their judgments in this area, if material. Other methodologies may also be appropriate if they meet the core objective of the new revenue standards.

Some stakeholders have identified complexities in applying the licensing accounting model for licenses satisfied at a point in time (i.e., functional IP) when there is more than one performance obligation – in particular when there is a sales- or usage-based royalty that also contains a minimum guarantee. At the most recent TRG meeting, the TRG confirmed that a minimum guarantee should be treated as fixed consideration; however, it did not address some of the complexities that exist in allocating minimum guarantees to multiple performance obligations or the interaction between the fixed consideration and the sales or usage based royalties. Judgment will be required when determining how to allocate a minimum guarantee to multiple performance obligations based on the facts and circumstances of these arrangements.

Multiple performance obligations

The new revenue standards require companies to identify all of the promises in a contract and to determine whether those promises are distinct. A performance obligation is a promise to transfer goods or perform services that are distinct from other promises in the contract. The criteria for separating performance obligations are similar to existing standards, but there are several differences.

New guidance	Current US GAAP	Current IFRS
<p>Identification of performance obligations</p> <p>The model requires promises that are "distinct" to be accounted for separately (assuming they are satisfied at different times). A good or service is distinct and should be accounted for separately if the customer can benefit from the good or service either on its own or together with other resources readily available to the customer and if the company's promise to transfer the good or service to the customer is separable from other promises in the contract (i.e., the promise to transfer the good or service is distinct within the context of the contract).</p>	<p>A company should identify all deliverables in an arrangement and then make a determination of the appropriate unit of account based upon the deliverables that have standalone value.</p>	<p>A company should apply the revenue recognition criteria to each separately-identifiable component of a single transaction, if necessary, to reflect the transaction's substance.</p> <p>The customer's perspective is important in determining whether the transaction should be accounted for as one element or multiple elements. The arrangement might be accounted for as one transaction if the customer views the purchase as one element.</p>
<p>Allocation of transaction price</p> <p>The transaction price should be allocated to each performance obligation based on relative standalone selling prices. If a standalone selling price is not available, companies should estimate it, maximizing the use of observable inputs.</p>	<p>For multiple element arrangements, consideration is allocated to separate units of account based upon the relative selling price.</p> <p>For software transactions, relative selling price can only be determined by VSOE.</p> <p>For non-software transactions, third-party evidence (TPE) of fair value is used to separate deliverables when VSOE of fair value is not available. Best estimate of selling price is used if neither VSOE nor TPE exist. The</p>	<p>While the application of IFRS implies that revenue should be allocated to individual components of a transaction, it does not provide any specific guidance on how that allocation should be determined, except that revenue should be measured at the fair value of the consideration received or receivable.</p> <p>In this context, as it relates to individual elements of a contract, the price regularly charged when</p>

New guidance	Current US GAAP	Current IFRS
	<p>term "selling price" indicates that the allocation of revenue is based on company-specific assumptions rather than assumptions of a marketplace participant. The residual or reverse residual methods are not allowed. Otherwise, the company's best-estimate of selling price is used.</p> <p>Amounts recognized in a multiple element transaction should be limited to consideration that is not contingent on future deliverables.</p>	<p>an item is sold separately is typically the best evidence of the item's fair value. Other approaches to estimating fair value and allocating the total arrangement consideration to the individual elements may be appropriate, including cost plus a reasonable margin, the residual method, and under rare circumstances, the reverse residual method.</p>

Potential impact

Sectors in Entertainment and Media most impacted

Film and TV production	TV and cable broadcasting	Information services & data	Advertising	Music	Publishing	Video games
√	√	√	√	√	√	√

Identifying performance obligations

Companies might identify different performance obligations under the new standards than under current guidance, and they may need to allocate the transaction price to those performance obligations differently than they do today. The following are common bundled arrangements which may include more than one performance obligation:

- Distribution agreements that provide customers with different services throughout the subscription period
- Advertising arrangements that involve the provision of creative, production, media buying and media planning services
- Licensing arrangements that provide access to library content as well as future updates (i.e., new content)
- The license of a music download to a consumer along with an obligation to continue to host the content remotely to allow for future downloads

In each of these situations, a company should first determine if its customer can benefit from a good or service on its own or together with resources readily available to it. The company will then need to determine if that good or service is separable from other promises in the contract, meaning it is distinct within the context of the contract. This determination will require judgment. The new standards provide indicators to help determine if a promise can be separated from other promises in the contract:

- Whether the company is providing a significant service of integrating the goods or services with other goods or services in the contract into a bundle of goods or services that represents the output the customer has contracted to receive
- Whether the good or service significantly customizes or modifies another good or service in the contract
- Whether the good or service is highly dependent on, or highly interrelated with, other goods and services in the contract. For example, the individual inputs combine to form one overall combined output

Within the E&M industry, these judgments may become more challenging with the growth of digital business models and the proliferation of on-demand streaming services and other emerging platforms.

Example 5: License to data files with updates

Facts: Data Co. licenses a business information database to a customer for a one-year period. Initial data files – reflecting the data as of the inception date of the arrangement - are delivered on the first day of the license term. Data Co. also promises to provide updates to the data on a when-and-if-available basis. Updates can include new information, changes to existing information, and removal of information that is obsolete. The initial data licensed is able to be used without the updates and is not significantly affected by the updates. The customer has requested that

an updated complete dataset be provided monthly versus providing only the change-based updated data. As a result, Data Co. has agreed to provide the customer 12 data files over the term: one at inception, and eleven that include updates, as applicable, at the beginning of each of the months in the term.

How many performance obligations does Data Co. have?

Analysis: Data Co. would likely identify two performance obligations: (1) a license to the initial data set and (2) a promise to provide the updates over the term. In this example, the fact that the initial licensed data can be used without the updates and is not significantly affected by the updates indicates that the licensed data, at inception, is a separate performance obligation.

The second performance obligation is a promise to provide updates to the data, on a when-and-if-available basis, over the contract term. In general, the manner in which the updates are agreed to be delivered (e.g., daily, weekly, monthly) generally will not impact the number of performance obligations identified. Typically, a promise to provide unspecified updates on a when-and-if-available basis will be viewed as a performance obligation recognized over the term using an appropriate measure of progress.

Within the E&M industry, there are a number of similar examples (e.g., film, television, or music content) whereby a company promises to provide a library of IP at inception as well as IP updates over the term. Typically, these arrangements result in a conclusion that the promises represent two separate performance obligations. However, analysis of the facts will be required to determine whether the promises are distinct or whether there is a single performance obligation.

Allocating transaction price

Allocating the transaction price across multiple performance obligations in an arrangement could differ from current practice in certain circumstances. The new revenue standards eliminate the requirement under current US GAAP to defer revenue that is contingent on future deliverables (sometimes referred to as the “contingent revenue cap”). This change means that companies need to allocate revenue to free or discounted products or services that are provided in a contract, even if compensation for those goods or services is contingent on transferring other goods or services promised in the contract.

Consider an advertising contract that provides free spots or other services at the inception of a contract with contracted spots billed at a higher rate. Under current US GAAP, no amounts are allocated to the free front-end spots, even if they have standalone value, since all consideration is contingent on providing the spots in the future. Under the new standards, the transaction price for the entire arrangement will be allocated to each of the spots based upon relative standalone selling price and revenue is recognized as each performance obligation is satisfied.

The standalone selling price of a good or service must be estimated if it is not sold on a standalone basis. The new standards allow for several approaches to estimate relative selling price. This change has the most impact compared to current US GAAP for software transactions (including video games). A company will no longer be required to demonstrate VSOE of fair value in bundled software arrangements to separately account for licenses as is currently required under US GAAP, aligning the guidance more closely with current IFRS.

Variable consideration

The transaction price is the amount of consideration to which a company expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price may include an element of consideration that is variable or contingent on the outcome of future events, including discounts, rebates, refunds, credits, incentives, performance bonuses and royalties.

Variable consideration is common in many forms in the E&M industry. Examples include sales- or usage- based royalties, price protection offered on home entertainment DVD sales, cumulative volume discounts offered to significant advertisers, and qualitative and quantitative performance bonuses in advertising contracts.

New guidance	Current US GAAP	Current IFRS
<p>Variable consideration should be estimated and included in the transaction price to the extent it is probable [US GAAP] or highly probable [IFRS] that a significant subsequent reversal in the cumulative amount of revenue recognized will not occur if estimates of variable consideration change.</p> <p>An exception is provided for revenue recognized from sales- or usage-based royalties stemming from licenses of IP. Royalties from licenses of IP should not be included in the transaction price until the subsequent sale or usage occurs, and the related performance obligation has been satisfied (or partially satisfied).</p>	<p>Revenue is recognized when the fee is fixed or determinable and when collection is reasonably assured. Royalty revenue is generally recognized in the same period as the sales that generate the royalty payment occur.</p>	<p>Revenue is recognized when it is probable of economic benefit and can be measured reliably.</p> <p>Revenue from royalties accrues in accordance with the terms of the relevant agreement and is usually recognized on that basis unless it is more appropriate to recognize revenue on some other systematic basis.</p> <p>Revenue is recognized for a license fee contingent on the occurrence of a future event only when the revenue is reliably measurable and it is probable that the fee will be received, which may be when the event has occurred.</p> <p>Revenue is recognized when the license is available for exploitation if the license fee or royalty is probable of being received and is reliably measurable.</p>

Potential impact

Sectors in Entertainment and Media most impacted

Film and TV production	TV and cable broadcasting	Information services & data	Advertising	Music	Publishing	Video games
√	√	√	√	√	√	√

Variable consideration other than sales- or usage-based royalties

Besides sales- or usage-based royalties, other forms of variable consideration are common in the E&M industry. A company may estimate variable consideration utilizing the expected value method (i.e., the estimate is the sum of probability-weighted amounts) or the most likely value method (i.e., the estimate is the single most likely result). A company must use the method that best predicts the variable consideration in the circumstances.

Factors to consider when determining whether it is probable [US GAAP] or highly probable [IFRS] that a significant reversal of revenue will not occur include the length of time of any underlying uncertainty, the company's prior experience with similar transactions, and the range of possible outcomes and the resulting impact on transaction consideration. A company that is currently deferring revenue from certain transactions pending the resolution of a price contingency may be required to recognize revenue earlier if there is a minimum amount that can be estimated that is probable [US GAAP] or highly probable [IFRS] of not having a significant revenue reversal in the future.

For example, an advertising agency that earns performance bonuses on marketing contracts will be required to estimate the bonuses to be achieved when recognizing revenue as the related performance obligations are fulfilled. When a company receives all of the bonus or none of it, a company might conclude that the most likely value is the most appropriate method. An agency that earns a fee that varies over a range of customer advertising outcomes may, however, determine that an expected value approach provides a better estimate of the transaction price. In all cases, the agency would need to consider the constraint and whether it is probable or highly probable that a significant reversal of revenue would not occur.

A similar analysis would be required for other forms of variable consideration, including adjustments to rates upon triggering a most-favored-nation clause and price protection that is offered on DVD or video game sales.

Barter transactions

Several E&M subsectors engage in barter transactions, typically exchanging advertising for advertising, goods or services. The new standards could change how the transaction price is measured in some situations in that they do not have industry-specific barter guidance. More specifically, the new standards do not contain specific guidance on advertising-for-advertising transactions. Further, existing guidance that provides an exemption for barter transactions involving the exchange of advertising time for network programming from being reported at fair value has been superseded.

New guidance	Current US GAAP	Current IFRS
Revenue is recorded at the fair value of cash and noncash consideration received or promised from the customer. The fair value is measured at contract inception. The constraint on variable consideration is applied when the fair value of noncash consideration varies only for reasons other than the form of consideration.	<p>Advertising for advertising</p> <p>Revenue and expenses should be recorded at fair value if the fair value of the advertising surrendered in the transaction is determinable based on the company's historical practice of receiving cash, marketable securities, or other consideration that is readily convertible to a known amount of cash for similar advertising from buyers unrelated to the counterparty in the barter transaction. If the fair value of the advertising surrendered in the barter transaction is not determinable, the barter transaction should be recorded based on the carrying amount of the advertising surrendered, which likely will be zero.</p> <p>Other than advertising for advertising</p> <p>Generally, nonmonetary transactions are based on the fair value of the assets or services involved, which is typically based on the fair value of the asset surrendered. The fair value of the asset received is used only if it is more clearly evident than the fair value of the asset surrendered.</p>	<p>Advertising for advertising</p> <p>Revenue is not recognized in an exchange of similar goods or services. However, if the medium of advertising exchanged is dissimilar in nature, revenue is recognized as the fair value of the advertising supplied. The fair value of such advertising would be measured by reference to similar non-barter transactions.</p> <p>Other than advertising for advertising</p> <p>Revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents received or paid. If the fair value of the goods or services received cannot be reliably measured, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of cash or cash equivalents received.</p>

Potential impact

Sectors in Entertainment and Media most impacted

Film and TV production	TV and cable broadcasting	Information services & data	Advertising	Music	Publishing	Video games
√	√	√	√	√	√	√

Judgment may be necessary to determine the fair value of advertising when a limited market exists and the fair value of noncash consideration. A company must first look to the value of the good or service received, as opposed to the good or service surrendered, when measuring noncash consideration received from a customer. This represents a change from current US GAAP that aligns with current IFRS.

Producers and distributors of TV and film IP often license their programs/films to TV stations and cable networks (broadcasters) for consideration that includes a fixed cash amount and the right to monetize advertising spots to be aired with the content (barter). Under the new revenue standards, the question arises as to whether the advertising time received should be accounted for as noncash consideration, which would require the producer to measure the advertising spots at fair value at contract inception. Under this view, the producer would record:

- Licensing revenue for both the cash consideration and the fair value of the advertising spots when the content is delivered to the broadcaster
- Advertising revenue (and corresponding cost of sales) for the subsequent sale of the advertising spots to advertisers.

Example 6: Accounting for rights to advertising spots received in a licensing arrangement (barter)

Facts: Producer licenses a TV series to Broadcaster for a three-year period. Producer receives (1) fixed cash consideration and (2) rights to a portion of the available advertising airtime within the licensed content (5 of the 10 available minutes of advertising spot airtime during each episode). Broadcaster obtains the rights to monetize the remaining advertising airtime.

How should Producer recognize revenue for the ad spots in this arrangement? How should the Broadcaster account for this arrangement?

Analysis:

Producer

The Producer would generally recognize revenue related to the advertising spots once they are sold to third parties. Some view the Producer as effectively monetizing its content in two ways with two different customers: (1) through the license of the content to the Broadcaster and (2) through the sale of adjacent advertising time to third-party advertisers.

Others may view the consideration received from the subsequent sale of advertising as an in-substance sales-based royalty related to the IP license which should not be recorded until the advertising sales occur. Either of these approaches would likely yield a similar financial reporting outcome.

Other companies may conclude that the advertising spots are noncash consideration received from the Broadcaster in exchange for the license. Companies applying this view should carefully consider how to value the advertising spots as the fair value impacts the amount of revenue recognized in the transaction. Under this view, the Producer will measure the fair value of the advertising spots at contract inception and record revenue for both the cash and noncash consideration when the content is delivered to the Broadcaster.

Broadcaster

Under current US GAAP, Broadcasters are generally required to record revenue and corresponding programming asset / expense for programming obtained in exchange for barter advertising spots (excluding network affiliate programming). Given the producers' accounting for these transactions, broadcasters should assess whether they believe a symmetrical accounting model would be appropriate (i.e., whether they should not gross up revenue and programming cost for barter advertising spots). Notwithstanding conclusions reached related to advertising spots granted inside of licensed programming, we anticipate that broadcasters will account for advertising spots provided in exchange for other goods or services (unrelated to the content in which the spots air) to be accounted for pursuant to the noncash consideration guidance in the new standards, consistent with current practice.

Principal versus agent

Some arrangements involve two or more unrelated parties that contribute to providing a specified good or service to a customer. In these instances, management will need to determine whether the company has promised to provide the specified good or service itself as a principal or to arrange for those specified goods or services to be provided by

another party as an agent. This determination often requires judgment, and different conclusions can significantly impact the amount and timing of revenue recognition.

Management should first understand the relationships and contractual arrangements among the various parties. This includes identifying the specified good or service being provided to the end customer and determining whether the company controls that good or service before it is transferred to the end customer. The new standards provide indicators to help management assess whether the company obtains control of the specified good or service.

New guidance	Current US GAAP	Current IFRS
<p>A company is a principal in a transaction if it obtains control of the goods and services of another party before it transfers control over those goods and services to the customer. A company that is a principal obtains control of any one of the following:</p> <ul style="list-style-type: none"> • A good from the other party that it then transfers to the customer • A right to a service to be performed by the other party that gives the company the ability to direct that party to provide the service to the customer on the company's behalf • A good or service that the company then combines with others in providing the specific good or service to a customer <p>If the determination of whether the company controls the specified good or service (i.e., is a principal) is unclear, companies should evaluate the following indicators :</p> <ul style="list-style-type: none"> • Primary responsibility for fulfilling the promise • Inventory risk • Discretion in establishing price <p>No relative weighting is provided to the indicators.</p>	<p>Current US GAAP provides indicators to determine whether gross or net reporting is more appropriate. The indicators that suggest gross reporting is appropriate are:</p> <ul style="list-style-type: none"> • The company is the primary obligor in the arrangement. • The company has general inventory risk. • The company has latitude in establishing price. • The company changes the product or performs part of the service. • The company has discretion in supplier selection. • The company is involved in the determination of product or service specifications. • The company has physical loss inventory risk after customer order or during shipping. • The company has credit risk. <p>The following indicators suggest net reporting is appropriate:</p> <ul style="list-style-type: none"> • The company's supplier is the primary obligor in the arrangement. • The amount the company earns is fixed. • The supplier has credit risk. 	<p>A company is a principal if it is exposed to risks and rewards when selling goods or providing services.</p> <p>Indicators that an company is acting as a principal in an arrangement are:</p> <ul style="list-style-type: none"> • The company is the primary obligor. • The company has inventory risk. • The company has pricing latitude. • The company has credit risk. <p>An indicator that a company is an agent is if the company earns a pre-determined fee.</p>

Potential impact

Sectors in Entertainment and Media most impacted

Film and TV production	TV and cable broadcasting	Information services & data	Advertising	Music	Publishing	Video games
√	√	√	√	√	√	√

Although the indicators in the new standards are similar to those in the current guidance, the purpose of the indicators is different. The new standards require a company to assess whether it controls the specified good or service, and the indicators are intended to support the control assessment. Under the new standards, no single indicator is determinative or weighted more heavily than other indicators. However, some indicators may provide stronger evidence than others, depending on the circumstances.

The principal versus agent assessment is often required for arrangements in the E&M industry. For example:

- Determining whether a content owner or an online retailer is the principal with respect to the sale of an electronic book, a movie or a song to a consumer
- Determining whether a producer or distributing studio is the principal with respect to film exploitation
- Determining which of many potential parties is the principal in an internet advertising transaction
- Determining whether a video game company is the principal when hosting third party gaming software on its platform

With the growth of digital business models, which often involve no physical goods and little inventory risk, we expect these judgments to increase in significance and complexity. Additionally, E&M companies who have previously reached a principal or agent conclusion based primarily on factors relating to which party has exposure to risk and rewards should evaluate the indicators of control under the new guidance.

Deferral of costs

Potential impact

Sectors in Entertainment and Media most impacted

Film and TV production	TV and cable broadcasting	Information services & data	Advertising	Music	Publishing	Video games
√	√	√	√	√	√	√

Current deferred or capitalized costs

Existing US GAAP includes a substantial amount of guidance related to the capitalization of costs specific to many E&M subsectors, principally related to the cost of developing content. Such industry-specific guidance does not exist in IFRS, so IFRS reporters follow the guidance for inventory or intangible assets to reach conclusions on capitalization and amortization.

Other costs to obtain or fulfill a contract

Incremental costs to obtain a contract will be capitalized if they are expected to be recovered. Such costs may be expensed as incurred as a practical expedient if the amortization period of the asset, including the initial contract term plus expected renewals, is one year or less.

Companies may be required to capitalize more costs under the new standards, such as certain subscription-based businesses that incur commission or agency costs at the time long-term subscriptions are executed.

Costs subject to capitalization are not just limited to commissions, but also include other costs that are incremental to obtaining the contract with the customer if the company expects to recover those costs, including fringe benefits. Unlike current US GAAP, capitalizable costs are also not required to be direct. At the November 2016 TRG meeting, the TRG discussed various examples to help preparers interpret what commission structures and other costs incurred when obtaining a new customer contract are incremental. The TRG noted that the concepts discussed also apply to fringe benefits.

Companies may need to apply judgment to determine whether there are factors (other than whether a contract is obtained) affecting the amount of the payment, which could indicate the payment is not an incremental cost. For example, a discretionary bonus that is based both on obtaining new contracts and other performance targets is not an incremental cost because there are other factors impacting whether the company will pay the bonus and the amount of the bonus.

The new revenue standards require companies to amortize capitalized costs on a systematic basis in a manner that is consistent with the transfer to the customer of the goods or services to which the asset relates. Determining the amortization period requires judgment and is similar to estimating the amortization or depreciation period for other assets (such as a customer relationship acquired in a business combination).

The amortization period is likely longer than the initial contract term if a company expects the customer to renew the contract and does not incur a commission commensurate with the initial commission upon renewal. However, the amortization period could be shorter than the average customer term, depending on the facts and circumstances. Companies should assess whether the asset relates to the goods and services the company expects to provide under future anticipated contracts with the customer.

Companies should assess costs incurred to fulfill a contract to determine if the accounting for those costs is in the scope of other applicable guidance. Costs incurred to fulfill a contract that are not in the scope of other applicable guidance are recognized as an asset under the new standards if the costs relate directly to a contract, generate or enhance resources of the company that will be used to satisfy future performance obligations, and are expected to be recovered. Costs capitalized under the new standards will be amortized as control of the goods or services to which the asset relates is transferred to the customer.

Many costs that E&M companies incur to fulfill a contract (e.g., the costs of installing newly acquired equipment) are currently covered by other guidance. However, the new standards may apply in certain instances to producers that construct assets for studios or other users on a contract basis because those costs do not fall within other literature.

The revenue standards do not significantly affect existing guidance on the accounting for traditional content costs that are developed during the initial creative process and are then expensed as the IP is exploited over time.

About PwC's Technology, Media, and Telecommunications (TMT) practice:

PwC's TMT practice strives to help business leaders in the Technology, Media and Telecommunications industries manage their complex businesses and capitalize on new windows of opportunity.

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