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**MIAG**
Media Industry
Accounting Group

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# *Making sense of a complex world*
# Revenue recognition: principal/agent arrangements – issues for media companies under IFRS 15

*This paper explores some of the key IFRS 15 accounting considerations for principal/agent arrangements by med companies.*

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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 and media sector.*

With more than 4,200 industry-dedicated professionals, PwC's global entertainment and media (E&M) practice has depth and breadth of experience across key industry sectors including: television, film, advertising, publishing, music, internet, video and online 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[1] aims to work together with the E&M 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

Sam Tomlinson

1 PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity

# Revenue recognition: principal/agent arrangements

*Revenue is – hopefully! – the largest item in the income statement so accounting judgements that directly affect revenue are invariably important. This 12th MIAG paper, a revision of our sixth paper, explores some of the key principal/agent accounting considerations for media companies under the new revenue recognition standard, IFRS 15 'Revenue from contracts with customers'.*

Principal/agent assessments are increasingly complex as digital transformation results in an ever-increasing variety of content formats and routes to reach the ultimate customers. For the media company – often the 'content provider' in such arrangements – the assessment of whether it is selling its content to a retailer, or to consumers via a distributor, has a direct impact on whether it recognises its revenues net or gross. This in turn affects two key metrics in opposite directions: revenue and percentage profit margin. Careful selection and communication of appropriate revenue recognition accounting policies for potential principal/agent arrangements is therefore a key part of managing capital markets stakeholders.

Although the indicators that are used in a principal/agent assessment under IFRS 15 are similar to those used under IAS 18, the underlying principle has changed to that of 'control'. This revised paper considers the same practical examples as before, covering physical books, eBooks, television content and film production.

However, in this paper, we apply the IFRS 15 principles to those same examples, hopefully in a way that highlights that the approach to the assessment is different. Our scenarios are clearly not designed to be exhaustive; but they will hopefully provide food for thought for media companies when considering the impact of IFRS 15 on new and existing routes to market.

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

Best wishes

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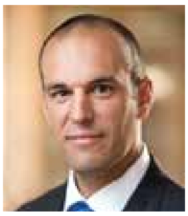

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# Background

*PwC's Media Industry Accounting Group (MIAG) is our premier forum for discussing and resolving emerging accounting issues that affect the entertainment and media sector – visit our dedicated website: www.pwc.com/miag*

Revenues 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 common feature of many media industries is that the 'content' owned by the media company requires a third party distribution route to reach the ultimate consumers. Distribution routes can be either traditional physical retailers or, increasingly, providers of telecommunications or online retail sites.

These arrangements – of content owner, distributor and consumer – require the content owner (media company) to assess whether the distributor is:

- **The customer of the media company,** in which case the media company would recognise the net consideration receivable from the distributor as revenue; or
- **An agent and the end consumers are the content owner's customers,** in which case the media company would generally recognise the gross consideration paid by the end consumer as revenue, with the distributor's fee usually recognised as a cost.

IFRS 15 contains limited explicit guidance on identifying whether the distributor is the media company's customer or merely its agent. However, IFRS 15 does contain extensive guidance for the distributor to determine whether it is the principal or the agent with respect to the end consumer. When the distributor is considered to be the principal in providing the media content to the end consumer, the distributor is the customer of the media company. In contrast, when the distributor is considered to be the agent in providing the media content to the end consumer, the end consumers are the customers of the media company. Consequently, it is useful in these arrangements to consider whether the distributor would be considered to be an agent or the principal in providing the media content to the end consumer.

A company is acting as a principal when the nature of its promise is to provide the goods or services itself. A company is acting as an agent when the nature of its promise is to arrange for the goods or services to be provided by another party. The key change in IFRS 15 compared to the existing revenue recognition guidance is that this assessment is based on **control**. The distributor would be the principal (and hence the media company's customer) if it **controls** the specified goods or services before they transfer to the end customer.

The assessment can be challenging for many media business relationships because it is often difficult to determine whether the distributor controls the content before it transfers to the end consumer. It is also complicated by digital transformation resulting in an ever-increasing variety of content formats and digital distribution routes, which do not have the benefit of historical experience and practice to inform the accounting judgements. And finally, with the introduction of IFRS 15, the principles and factors to consider have also now changed, meaning traditional arrangements may need to be reconsidered in light of the new accounting guidance.

### *What is the relevant IFRS guidance?*

The new revenue standard provides additional guidance on revenue recognition under principal/agent arrangements. Following the issuance of IFRS 15 in May 2014, questions were raised on the principal/agent guidance, including:

- Is control always the basis for determining whether the company is a principal or agent?
- How the control principle and the principal/agent indicators work together?
- How should the control principle be applied to contracts involving intangible goods or services?

In light of the questions and subsequent discussion thereof, in April 2016, the International Accounting Standards Board (IASB) decided to clarify the principal/agent guidance and amend the related examples in the standard.

Following these amendments, the application guidance sets out the following two step process that a company would apply in determining if it is a principal or agent in a contract with a customer:

a. identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party); and
b. assess whether it controls each specified good or service before that good or service is transferred to the customer.

Identifying and understanding a company's promise (i.e. its performance obligation), and determining if the company controls these goods or services before their transfer to the customer, is fundamental to determining if the company is the principal or an agent. A company controls an asset if it has the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset. This includes the ability to prevent others from directing the use or obtaining the benefits of the asset.

Whether or not the company controls the goods or services before they are transferred might not always be readily apparent, especially if the item to be transferred is an intangible item or a service, as is often the case for a media company. For that reason, the IFRS 15 guidance includes indicators to help a company determine whether it controls the goods or services before transferring them and thus whether the company is a principal or agent. Those indicators are based on the principal/agent indicators that were included in the previous IFRS revenue recognition requirements. However, the indicators in IFRS 15 have a different purpose than previous revenue recognition requirements in that they are based on the concepts of identifying performance obligations and the transfer of control of goods or services. The indicators (a) do not override the assessment of control; (b) should not be viewed in isolation; (c) do not constitute a separate or additional evaluation; and (d) should not be considered a checklist of criteria to be met, or factors to be considered, in all scenarios. Considering one or more of the indicators will often be helpful and, depending on the facts and circumstances, individual indicators will be more or less relevant or persuasive to the assessment of control.

Indicators in IFRS 15 that a company should account for a transaction as principal are as follows:

- **The company has the primary responsibility for fulfilling the promise to provide the specified goods or services to the customer** – This typically includes responsibility for the acceptability of the specified good or service (e.g. primary responsibility for meeting customer specifications). If the company is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the company's behalf.
- **The company has inventory risk before the specified good or service has been transferred to a customer, or after transfer of control to the customer (for example, if the customer has a right of return)** – For example, if the distributor obtains, or commits itself to obtain, the specified content before obtaining a contract with an end customer, that may indicate that the distributor has the ability to direct the use of, and obtain substantially all of the remaining benefits from the content before it is transferred to the end consumer. For this indicator the general sales risk of the developed good could also be considered i.e. who bears the greater risk from the investment in content and distribution.
- **The company has discretion in establishing the price for the specified good or service** – Establishing the price that the customer pays for the specified good or service may indicate that the company has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.

This paper addresses the assessment of the key principal/agent considerations for media companies in various practical examples covering physical books, eBooks, television content and film production. Our scenarios are clearly not designed to be exhaustive; but they will hopefully provide food for thought for media companies as they consider the new guidance for principal/agent assessments under IFRS 15. In many cases, the answer may be unchanged, however, because the underlying principles have changed, media companies should not assume that their conclusions under existing revenue recognition guidance will remain the same under IFRS 15. 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 principal/agent, which impacts revenue recognition, might also affect sales tax.

Some countries will have tax legislation specifically designed to address principal/agent debates, 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 catch the attention of local tax authorities or accounting regulators. Direct tax authorities might also pay close attention to sales to, or distribution by, 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 a principal/agent assessment.

# *Example 1:* Book sale-or-return arrangement

### *Scenario*

Book publisher B produces the content for a book and arranges the physical printing. B enters into contracts with booksellers for the sale of books, to booksellers including retailer R. Book publisher B invoices retailer R for an agreed price per unit. B suggests, but cannot enforce, a retail selling price.

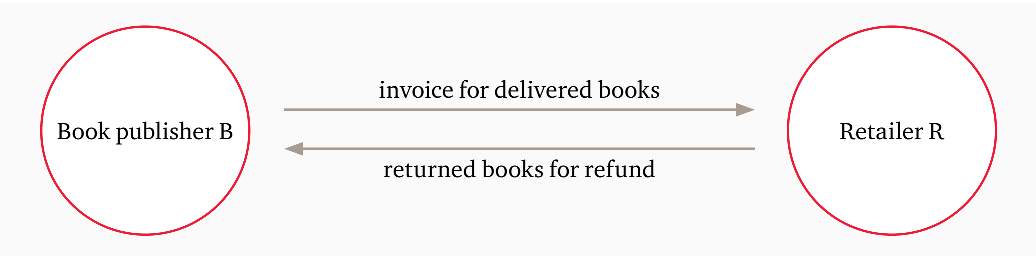
The arrangement includes a sale-or return clause meaning that retailer R can return any unsold books at the same price per unit originally invoiced by book publisher B. Books can be returned by R to B for a period of up to 12 months after original shipment.

For this example, assume book publisher B charges retailer R €9 for each book and R generally charges consumers the suggested retail price of €10.

### *How should book publisher B account for printed book sales?*

In this scenario, book publisher B must assess whether retailer R is:

- Its customer, in which case book publisher B would recognise the net consideration receivable of €9 as revenue; or
- An agent and the end consumers are publisher B's customers, in which case book publisher B would generally recognise the €10 paid by the end consumer as revenue, and recognise €1 as an acquisition cost paid to retailer R.




### *Assessment of whether retailer R controls the goods or services before transfer*

In order to determine whether retailer R is the customer or agent of book publisher B, it is useful for book publisher B to consider whether retailer R would be considered to be an agent or the principal in providing the books to end consumers.

Book publisher B should identify the specified goods or services to be provided to the end consumer from retailer R's perspective and assess whether retailer R controls those goods or services before they are transferred to the end consumer. In this fact pattern, the specified goods or services are the physical books and there do not appear to be any other goods or services promised to the customer.

Book publisher B concludes that retailer R does control the books before they are transferred to the end consumer, since retailer R has the ability to direct the use of the books before they are transferred.

For example, retailer R can sell the books to any end consumer that it chooses and prevent book publisher B from transferring the books to other parties once retailer R takes delivery of the books. Retailer R controls the inventory of books that it holds and manages that inventory to fulfil demand from end consumers.

As part of reaching this conclusion, book publisher B considers the indicators of whether retailer R would be considered the principal and therefore the customer of book publisher B:

| Indicator | Assessment by book publisher B |
|---|---|
| **Primary responsibility for fulfilling the promise to provide the specified goods or services** | • Although book publisher B retains responsibility for the content of the book (along with, potentially, the book's author), retailer R is primarily responsible for fulfilling the promise to provide the books to end consumers. Retailer R is primarily responsible for the acceptability of the books from the end consumer's perspective and would generally be the party that end consumers contacted if there was an issue with the book e.g. blank pages or damage<br>• **This indicates retailer R controls the books before they are sold to end consumers** |
| **Inventory risk before or after transfer of control to the customer (for example, if the customer has a right of return)** | • Although retailer R has obtained the books before they are sold to end consumers, book publisher B retains the risk that they cannot be sold at a profit since books that are unsold within 12 months can be returned<br>• However, retailer R has physical possession of the books so the risk of damaged or stolen books resides with R. In addition, R has full inventory risk for books that were delivered more than 12 months previously if these are not returned<br>• **This indicator is mixed** |
| **Discretion to establish prices** | • R sets the price for customers. While R generally uses the retail price suggested by B, R has latitude to vary from this<br>• **Indicates retailer R controls the books before they are sold to the end consumers** |

### *Conclusions*

In summary, the goods and services being considered are the physical books. Retailer R appears to control the books before they transfer to end consumers because retailer R can direct the use of the books to obtain substantially all of the remaining benefits from the books. Retailer R also has the ability to prevent others from directing the use of the books and obtaining benefits from the books. This conclusion is confirmed by considering the indicators. As such, book publisher B's customer is retailer R so book publisher B recognises revenue of €9 per book. (NB: revenue is not recognised for books that are expected to be returned by R as control of these books does not transfer between B and R. Accounting for returns is not addressed in this paper.)

However, if some of the facts and circumstances were varied, the determination could be different. In some territories the book publisher might have the legal right to set the selling price to the customer, and might also retain more of the inventory risk given local arrangements such as extended multi-year return periods. In such a scenario, careful consideration would need to be given to whether the Retailer continued to have the ability to direct the use of the books to obtain substantially all of the remaining benefits from the books.

As always, the assessment in real life should be determine by the specific facts and circumstances including contractual terms, applicable laws and local industry practice.

# ***Example 2:*** eBook sales via online retailer

### *Scenario*

Online retailer O sells eBooks with the eBook content being provided to O by eBook publisher E. O is responsible for transforming E's digital files into a digital format that can be sold on O's website and downloaded by consumers on to their eReader device, although this 'transformation' process is relatively straightforward and does not represent 'significant modification'.

The eBook price charged to consumers is set by online retailer O but within narrow, contractually-determined boundaries agreed with E. The consumers pay the eBook price to O, which retains a set amount per sale (O's fee) and remits the remainder to eBook publisher E. If a refund is provided to the consumer for any reason, online retailer O makes this payment but eBook publisher E must return to O any cash previously received for that eBook.

The agreement between online retailer O and the consumer states that O is responsible for delivery of the content to the consumer. If any defect is caused by E's content, O reverts to E for correction.

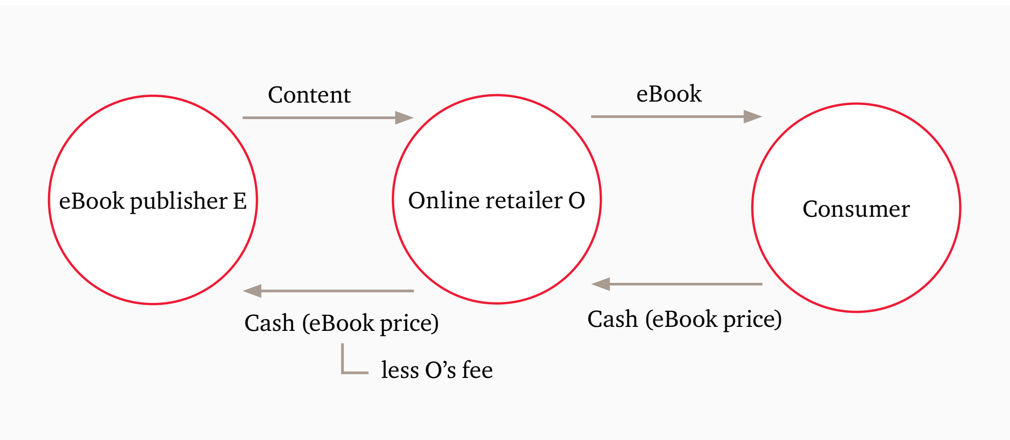
Online retailer O has signed an exclusivity agreement with eBook publisher E in that region, meaning no other online retailer is able to sell E's eBooks in that region.

In this scenario, assume that online retailer O charges consumers a price between €9.99 and €10.15, as permitted by its contract with eBook publisher E, with E receiving 70% of the price paid by the consumer.

### *How should eBook publisher E account for eBook sales?*

eBook publisher E must assess whether online retailer O is:

- Its customer, in which case eBook publisher E would recognise the net consideration receivable of €6.99 – €7.10 as revenue; or
- An agent and the end consumers are eBook publisher E's customers, in which case eBook publisher E would generally recognise the €9.99 – €10.15 (depending on the actual selling price) paid by the end consumer as revenue, and recognise €3.00 – €3.05 as cost paid to online retailer O.



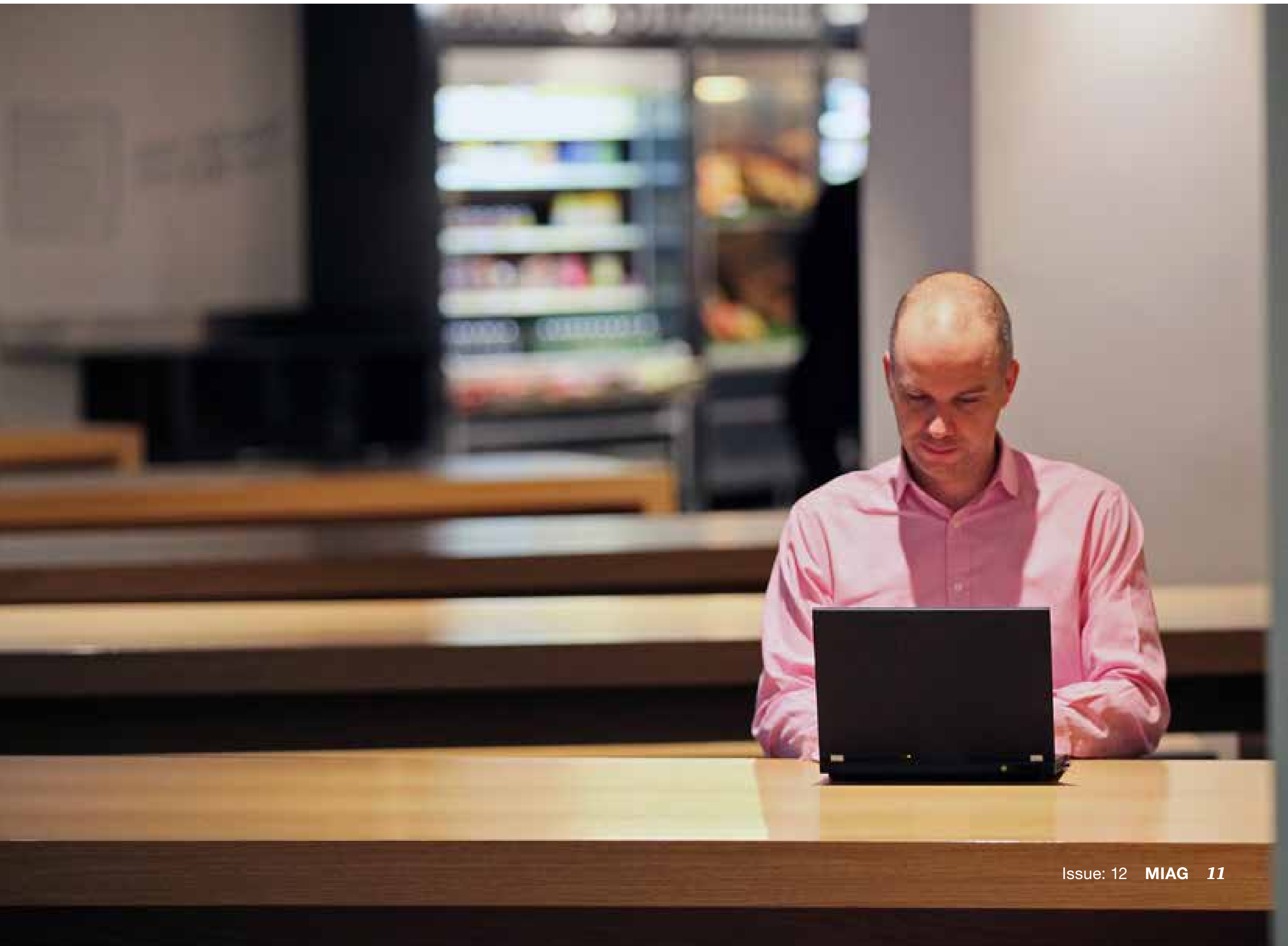
### *Assessment of whether online retailer O controls the goods or services before transfer*

In order to determine whether online retailer O is the customer or agent of eBook publisher E, it is useful for eBook publisher E to consider whether online retailer O would be considered to be an agent or the principal in providing the eBooks to end consumers.

eBook publisher E should identify the specified goods or services to be provided to the end consumer from online retailer O's perspective and assess whether online retailer O controls those goods or services before they are transferred to the end consumer. In this fact pattern, the specified goods or services are the digital eBooks (i.e. a licence to intellectual property) and there do not appear to be any other goods or services promised to the customer.

In addition, because the promised good or service represents a licence of intellectual property, online retailer O would need to determine whether the licence represents a 'right of use' or a 'right of access'. For purposes of this example, we have assumed that the licence represents a right to use eBook publisher's intellectual property as it exists at the point when the license is granted, i.e. the revenue for each eBook sold is recognised at a point in time.

eBook publisher E considers whether online retailer O controls the eBooks before they are transferred to the end consumer. eBook publisher E notes that online retailer O might appear to have the ability to direct the use of the eBooks before they are transferred to the end consumers relating to the eBooks in that region as a result of the exclusive agreement. For example, although the sub-licence to each consumer is only created at the point of sale, online retailer O can direct how the eBooks will be marketed and delivered to any end consumer that they choose via their online portal and prevent eBook publisher E from transferring the books to other parties as a result of the exclusivity agreement. However, E does not consider that the O's ability to issue sub-licences to any end customer is clearly determinative of control. It is also not clear whether O obtains substantially all of the benefits given the restrictions on pricing.



Therefore eBook publisher E also considers the indicators of whether online retailer O would be considered the principal and therefore the customer of book publisher B:

| Indicator | Assessment by eBook publisher E |
|---|---|
| **Primary responsibility for fulfilling the promise to provide the specified goods or services** | • O is responsible for technical infrastructure and download format as well as digital delivery to the consumer<br>• If there is an issue with the digital content, end consumer is likely to contact online retailer O to resolve the issues<br>• However, E is responsible for the content that, in the absence of a physical product, is the key sales driver<br>• **This indicator is mixed but indicates that online retailer O is more likely to have the primary responsibility to the end consumer to fulfil the delivery of a working eBook** |
| **Inventory risk** | • There is no traditional inventory risk for eBooks since there is no physical product, although as noted any 'returns' would be O's responsibility in the first instance<br>• There is some investment recoverability risk for E given its investment in the author and editorial activities (though it is likely that the investment will be recovered via more than one sales channel i.e. by physical books as well as eBooks). In this scenario, O has minimal inventory risk since the transformation process is straightforward and does not constitute a significant modification<br>• **The lack of physical inventory means this indicator is not very relevant so not determinative** |
| **Discretion to establish prices** | • O sets the price charged to ultimate consumers<br>• However, since the boundaries in this scenario are narrow, this limits O's ability to obtain 'substantially all of the remaining benefits from the eBooks'<br>• If boundaries were 'broad' this indicator might be different (there would be significant judgement in deciding whether a particular range is 'narrow' or 'broad')<br>• **This indicator is mixed and but indicates eBook publisher E has more discretion than online retailer O** |

### *Conclusions*

The assessment of eBook revenue recognition is, as always, dependent on specific contractual terms and business practices, which are rapidly changing as the eBooks market develops (e.g. cloud versus downloads) and the variety of digital devices increases.

In the scenario described above, taking into account the exclusivity agreement, O's ability to choose how to market the product and issue licences to any consumer of its choice in the territory, the fact that on balance O appears to be the primary obligor and the fact that O has some latitude to establish prices, we would probably conclude that the online retailer is most appropriately viewed as principal in its dealings with end consumers. As such, eBook publisher would identify online retailer O as its customer and recognise revenue on a net basis. It is worth noting that eBook publisher would probably only recognise revenue when online retailer O makes its subsequent sales because the arrangement would most likely be considered a sales-based royalty, for which specific guidance exists under IFRS 15.

Alterations of this scenario's fact pattern could result in a different conclusion. For example, if the online retailer is merely a conduit and end consumers can (and do) contact the eBook publisher directly, this might indicate that the online retailer is merely a platform through which eBook publishers connect with end consumers, rather than being the primary obligor. Similarly, if the agreement to sell eBooks between E and O was non-exclusive, this might lead to online retailer O concluding that it could not restrict others' ability to sell the eBooks and therefore is less likely to control them before they transfer to the end consumer.

There is currently some diversity in practice among eBook publishers in assessing such relationships as principal/agent (with the eBook publisher selling to ultimate customers using the online retailer as its agent) or as a direct sale to the online retailer (where the online retailer is viewed as the customer of the eBook publisher). This is at least partly due to differing contractual terms and these judgements under IFRS 15 will continue to be complex.

Since the publication of our original sixth MIAG paper, eBook (and similar) revenues have become more material and the variety of digital devices have increased. We expect that the volume and type of contracts between publishers and online retailers will continue to grow. As demonstrated in this example, the outcome can be different from the previous conclusions under IAS 18. eBook publishers should reconsider these types of arrangements under IFRS 15 to ensure that the conclusions are still valid when control is used as the underlying principle.

Similar considerations to those set out above would apply for a music publisher selling music downloads or for a company selling an 'app' via an online store.

# *Example 3:* Television content distribution

### *Scenario*

A telecommunications company (TelCo) provides services including telephone, internet and cable television. All services are available standalone or combined in various 'entertainment packages'. Television content (the 'TV package') is provided by television company TVCo.

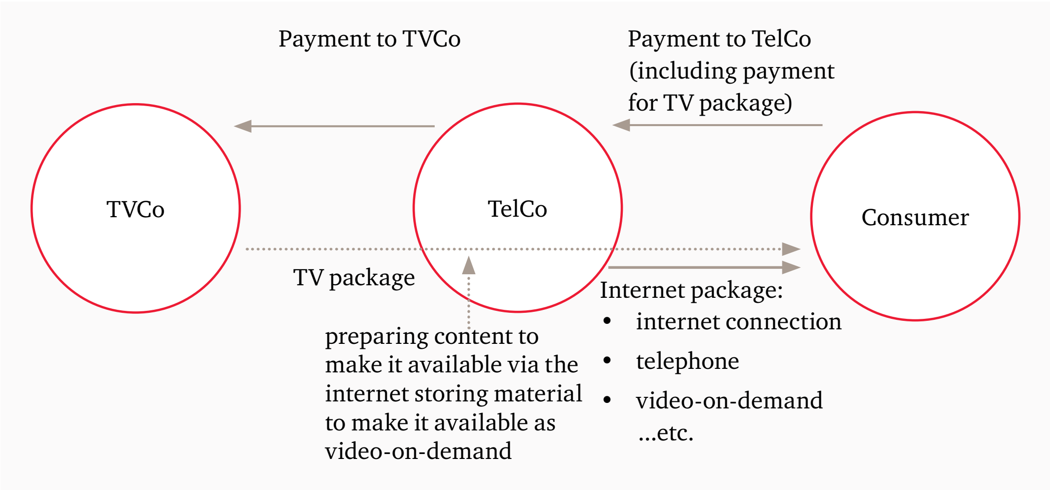
Some of TelCo's entertainment packages allow television broadcasting via the internet. TelCo stores TVCo's full library of a back catalogue of television material so that TelCo customers have the opportunity at any time to search and watch specific material ('video-on-demand').

The contractual arrangement between TelCo and TVCo allows TelCo to sell the TV package of TVCo in conjunction with other TelCo products i.e. bundled within TelCo's various entertainment packages. TelCo pays a primarily fixed up front fee to TVCo and assumes customer credit risk. The contract includes provisions for TelCo to pay more than the 'fixed' fee if TVCo's content proves exceptionally popular with TelCo's subscribers.

### *How should TVCo account for revenues under this arrangement?*

TVCo must assess whether TelCo is:

- Its customer, in which case TVCo is selling its content directly to TelCo i.e. record net revenues; or
- An agent and the end consumers are the customers of TVCo, in which case TVCo would generally recognise revenue at the amount received from end consumers and the amount retained by TelCo as a customer acquisition cost.




### *Assessment of whether the TelCo controls the goods or services before transfer*

In order to determine whether TelCo is the customer or agent of TVCo, it is useful for TVCo to consider whether TelCo would be considered to be an agent or the principal in providing the television content to end consumers. In addition, because the promised good or service represents a license of intellectual property, TVCo would need to determine whether the license represents a 'right of use' or a 'right of access'. For purposes of this example, we have assumed that the licence represents a right to use TVCo's intellectual property as it exists at the point when the licence is granted, i.e. the revenue for provision of the television content is recognised at a point in time.

TVCo should identify the specified goods or services to be provided to the end consumer from TelCo's perspective and assess whether TelCo controls those goods or services before they are transferred to the end consumer. IFRS 15 has clarified that a company can be the principal for some of the promised goods and services and an agent for others in a transaction with a customer. In this example, TVCo has determined that the television content can and should be considered as a separate performance obligation from the voice and data services that TelCo provides to the end consumers to determine whether TelCo is the customer or agent for the television content.

TVCo considers whether Telco controls the television content before it is transferred to the end consumer. TVCo concludes that TelCo has the ability to direct the use of the television content before it is transferred to the end consumers. However, it is not clear whether TelCo can obtain substantially all the benefits relating to the television content and restrict others from directing the use of the television content because TVCo can still license the content to other companies.

Consequently, TVCo considers the indicators in helping it determine the nature of TelCo's promise to the end consumer and whether TelCo controls the television content before it transfers to end consumers:

| Indicator | Assessment by eBook publisher E |
|---|---|
| **Primary responsibility for fulfilling the promise to provide the specified goods or services** | • Although both companies clearly contribute to provision of these services, an ultimate consumer would most likely view the supplier of the television content as TelCo, particularly where services are bundled or in the event of issues<br>• **Indicates TVCo is selling its content to TelCo, with TelCo controlling the television content before providing it to the end consumers** |
| **Inventory risk** | • There is no traditional inventory risk since there is no physical product<br>• However, TelCo commits itself to obtain the specified good (ie the television content) before this is transferred to the end consumer by virtue of the fixed up front payment<br>• **TelCo paying a fixed up front fee for the right of use of the content indicates that it has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the television content** |
| **Discretion to establish prices** | • Each company is responsible for the price of its own products<br>• TVCo sets the price it charges TelCo<br>• TelCo sets the price charged to consumers for its entertainment packages and can combine TVCo's content with other content<br>• **Indicates TVCo is selling its content to TelCo, with TelCo then controlling the content before it transfers to end consumers** |

***Conclusions***

Both companies are responsible for providing services, with TVCo providing content and TelCo providing infrastructure. In considering the definition of control, it is difficult to conclude whether TelCo controls the television content before it transfers to the end consumer. However, on balance, when considering the indicators, this suggests that TVCo is selling to TelCo rather than using TelCo as its agent to sell to the ultimate customers. As such, TVCo should recognise only the net revenues received from TelCo.

However, scenarios can be envisaged where the conclusion would be different. For example, if the video-on-demand content was available solely on a pay-per-view basis, with the price set by TVCo and no fixed payment required by TelCo, this might indicate that TelCo did not control the content before it transferred to the end consumer.

In some scenarios it can also be relevant to consider who the end consumer believes has primary responsibility for providing the content i.e. do consumers believe they are 'accessing TVCo content' (via TelCo) or 'being provided content by TelCo' (content that happens to be generated by TVCo). It might be helpful to consider both TVCo and TelCo marketing materials when making this assessment. The 'TVCo content access' view would imply that TVCo's customer is the end consumer, so TVCo should recognise revenue gross, with the amount retained by TelCo representing a customer acquisition cost of sale. In contrast, the 'TelCo content provision' view implies that TVCo is selling to TelCo so should recognise just the net revenue received.

# *Example 4:* Film production

### *Scenario*

A film company (MovieCo) develops film concepts. Its activities include location scouting, logistics organisation and project and budget management.

MovieCo has been commissioned by another company (MovieDistributor) to work on the production of a film. Accordingly, MovieCo has entered into a contract with MovieDistributor covering concept development for this film.

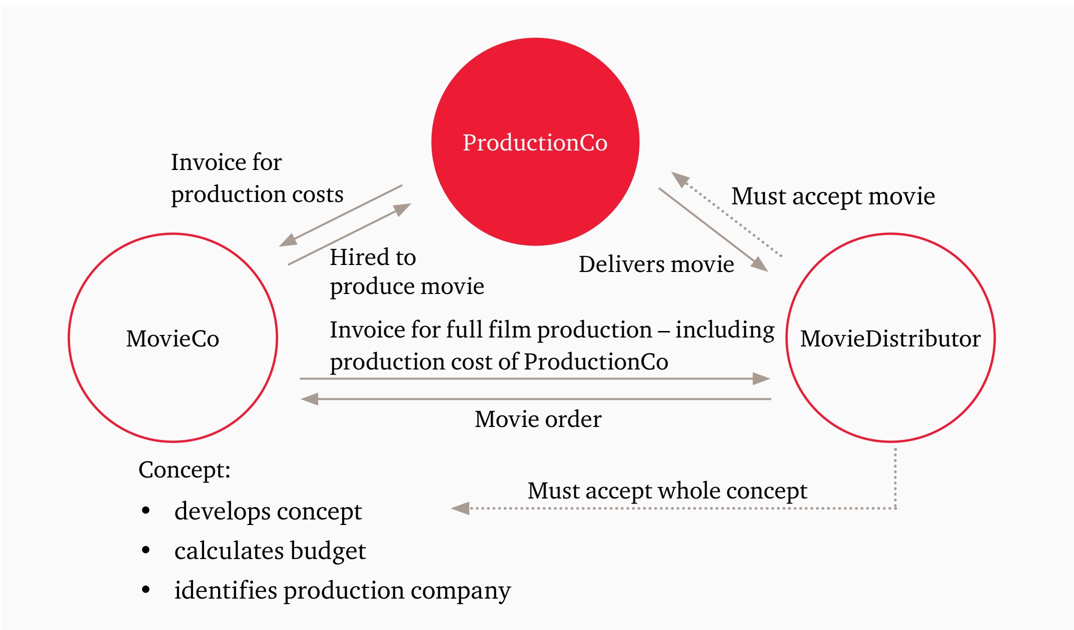
MovieCo develops the concept, calculates the budget and searches for a third company that will produce the movie – with these details being presented to MovieDistributor. After approval of concept, budget and the production company (ProductionCo) by MovieDistributor, MovieCo hires ProductionCo to produce the movie based on the agreed concept and budget.

ProductionCo is responsible for the technical quality and delivery of the movie with the final movie being approved and accepted by MovieDistributor. MovieCo is responsible for areas such as logistics, project and budget management and scouting. After final acceptance, MovieCo provides an invoice to MovieDistributor for the total amount of the movie production including costs charged by ProductionCo and a 10% mark-up for MovieCo's own services.

### *How should MovieCo account for the amounts it invoices to MovieDistributor?*

MovieCo must assess whether it is acting as:

- Principal in selling the finished film it controls to MovieDistributor i.e. recognise as revenue the full amount invoiced, including 10% mark-up; or
- Agent acting on behalf of MovieDistributor (to source ProductionCo), in which case it would recognise revenue to the extent of its 10% mark-up (excluding ProductionCo's costs).



### *Assessment of whether MovieCo controls the goods or services before transfer*

MovieCo should identify the specified goods and/or services to be provided to MovieDistributor and assess whether it controls those goods or services before they are transferred to MovieDistributor. In order to identify the specified goods and/or service provided to the customer MovieCo should determine if its performance obligation is to provide the finished film to MovieDistributor or to assist MovieDistributor by sourcing ProductionCo on its behalf.

MovieCo concludes that it has promised to provide MovieDistributor with a finished film. Although MovieCo has subcontracted the production of the film to ProductionCo, MovieCo concludes that the concept and production are not distinct under IFRS 15 (i.e. there is only one promise which is an integrated finished film). This is because MovieCo is responsible for the overall management of the contract, for example, organising changes to locations, talent or script if necessary during production and communicating these changes to the production company. And so MovieCo's activities are highly interrelated with the production that it has outsourced.

MovieCo concludes that it controls the finished film before it transfers to MovieDistributor based on the specific guidance in IFRS 15, which states that if a company provides a significant service of integrating goods or services provided by another party into the good or service for which the customer has contracted, the company does have control before the good or service is transferred to the customer. This is because the company first obtains control of the inputs to the good or service that will be transferred (which includes goods or services obtained from other parties) and directs their use to create the combined output that is good or service that the customer will receive. MovieCo provides the significant integration service necessary to produce the finished film and, therefore, controls the finished film before it transfers to MovieDistributor. MovieCo directs the use of ProductionCo's service as an input in creating the combined output that is the finished film.

Thus, MovieCo concludes that it is the principal in the transaction. MovieCo does not need to consider the indicators in IFRS 15 because the evaluation is conclusive without consideration of the indicators based on the specific guidance in IFRS 15 (related to the principal versus agent analysis when integration services are provided). MovieCo therefore recognises the gross amount received from MovieDistributor as revenue, with the amounts paid to ProductionCo recognised as a cost of services.

### *Conclusions*

MovieCo identifies the promised good in the arrangement as the finished film. Because MovieCo is responsible for combining the various goods/services to provide MovieDistributor with the integrated finished film, MovieCo is seen to control the inputs needed to provide the finished film and directs the use of the inputs (i.e. ProductionCo's efforts) to create the combined output (i.e. the finished film) that is the good/service that MovieDistributor purchased.

MovieCo would therefore control the film before the sale and would recognise the gross amounts received from MovieDistributor as revenue.

However, changes in certain facts could influence this assessment. For example, the contract might specify that MovieDistributor will work directly with the production company. MovieCo has no involvement in production and just receives a fixed fee after providing the concept to MovieDistributor and introducting ProductionCo to MovieDistributor. In that case, MovieCo would identify the nature of its promise as merely the delivery of the film concept and arranging for ProductionCo and DistributorCo to meet each other. Therefore MovieCo would not control the inputs to the movie before they are integrated and would be an agent in the arrangement.

# Conclusion

Principal/agent assessments are becoming increasingly complex as digital transformation results in an ever-increasing variety of intangible content formats and routes to reach the ultimate consumers. For the media company – often the 'content provider' in such arrangements – the assessment of whether it is selling its content to a retailer/distributor, or to consumers via an agent, has a direct impact on whether it recognises its revenues net or gross. This in tum affects two key metrics in opposite directions: revenue and percentage profit margin.

This paper has considered the assessment of the key principal/agent considerations under IFRS 15 in various scenarios covering physical books, eBooks, television content and film production.

Our scenarios are clearly not designed to be exhaustive; but they will hopefully provide food for thought for media companies when considering the impact of IFRS 15 on new and existing routes to market. 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 would not expect the principal/agent amendments in IFRS 15 to result in pervasive changes to previous gross/net assessments. It is possible, however, that some conclusions could change based on the control principle and other clarifications to the guidance. Management should plan sufficient time to review and understand the terms of their contracts with customers and vendors to ensure time for appropriate conclusions to be reached under IFRS 15.

We hope you find 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.

# *Further reading*




**MIAG Issue: 3**

Broadcast television: Acquired programming rights

This paper explores the critical considerations under IFRS relating to the recognition, presentation, amortisation and impairment of acquired programming rights.

**MIAG Issue: 4**

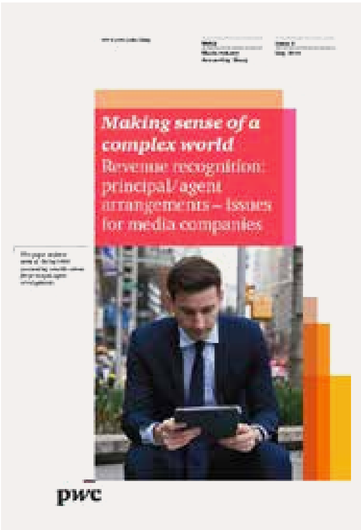
Accounting for royalty arrangements – issues for media companies

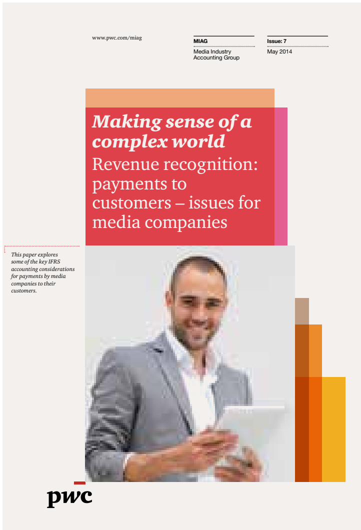
This paper explores some of the key considerations under IFRS in accounting for royalty arrangements by both licensors and licensees.

**MIAG Issue: 5**

Content development and cost capitalisation by media companies

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.





### MIAG Issue: 6

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.

### MIAG Issue: 7

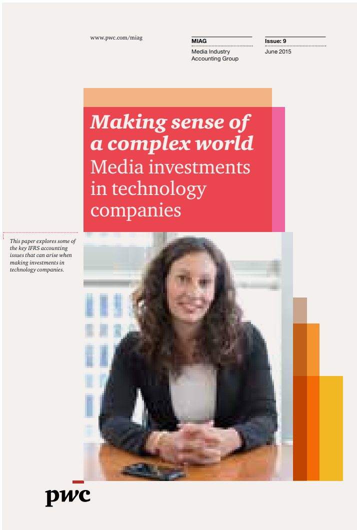
Revenue recognition: payments to customers – issues for media companies

This paper explores some of the key IFRS accounting considerations for payments by media companies to their customers, covering the purchase of advertising space, physical and digital 'slotting fees', outsourced advertising sales and video game prizes.

### MIAG Issue: 8

Online gaming: Real issues in virtual worlds

This paper explores some of the key IFRS revenue recognition issues in the world of online gaming, covering principal/agent considerations, virtual items and virtual currencies, and multiple element arrangements.






### MIAG Issue: 9

Media investments in technology companies

This paper explores some of the key IFRS accounting issues that can arise when making investments in technology companies.

### MIAG Issue: 10

Film cost capitalisation, amortisation and impairment.

This paper explores some of the key considerations under IFRS for film cost capitalisation, amortisation and impairment.

### MIAG Issue: 11

Film financing arrangements

This paper explores some of the key considerations under IFRS for film financing arrangements.

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# *Notes*

# Notes

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