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Sehr geehrte Damen und Herren,

für Rückfragen zur beigefügten Ergänzung „Entertainment and media industry supplement“ zu unserer Publikation „In depth“ zur Thematik „Revenue from contracts with customers“ stehen Ihnen folgende Ansprechpartner gerne zur Verfügung:



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In depth

A look at current financial reporting issues



Revenue from contracts with customers

The standard is final – A comprehensive look at the new revenue model

Entertainment and media industry supplement

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At a glance

On 28 May, the IASB and FASB issued their long-awaited converged standard on revenue recognition. Almost all entities will be affected to some extent by the significant increase in required disclosures. But the changes extend beyond disclosures, and the effect on entities will vary depending on industry and current accounting practices.

[In depth INT2014-02](#) is a comprehensive analysis of the new standard. This supplement highlights some of the areas that could create the most significant challenges for entertainment and media entities as they transition to the new standard.

Overview

The entertainment and media sector comprises a diverse set of sub-sectors, including filmed entertainment, television, music, video games, publishing, radio, and internet. This supplement explores the effect of the new revenue standard on these businesses, and contrasts it with current practice under IFRS and US GAAP.

This supplement provides an initial analysis of key questions and issues facing the industry which will continue to evolve as entities address the challenges of implementation. The examples and related discussions herein are intended to highlight areas of focus to assist entities in evaluating the implications of the new standard. The new revenue standard is principles-based, requiring the application of significant judgement.

Scope

The standard applies to all contracts with customers, excluding leases, financial instruments, certain guarantees and arrangements in the scope of other guidance. A customer is defined as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities.

Entities in the entertainment and media sector will need to evaluate their collaborative arrangements to determine if those arrangements are contracts with customers and thus in the scope of this standard. A contract outside the scope of the standard is one in which a collaborator or partner shares in the risk of developing a product rather than obtaining an output of the entity'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 is not in the scope of the revenue standard if the parties share the risk of developing the film. Alternatively, it will likely be in scope if the substance of the arrangement is that the studio is selling its film to the counterparty or providing production services.

Licences

Licences in the entertainment and media sector take a variety of forms, such as rights to a syndicated television show, a licence to a music catalogue, or a licence to utilise an animated character's image. Throughout the deliberations of the standard, there were many viewpoints and models discussed. The standard includes a model that recognises revenue from certain licences upfront and others over time.

Right to use versus right to access

New standard	Current US GAAP	Current IFRS
<p>The standard emphasises the need to consider whether a licence is distinct from any other performance obligations in an arrangement. A licence is distinct if a customer can benefit from it on its own or together with other resources that are readily available, and the licence is separable from other obligations. If it is not distinct, revenue is recorded based upon the transfer of the combined performance obligation.</p> <p>Licences are either a promise to provide a right to the entity's intellectual property (IP) at a point in time, or a promise to provide access to an entity's IP as it exists at any point during the licence period.</p> <p>Licences that provide access to an entity's IP over time have all of the following characteristics:</p> <ol style="list-style-type: none"> 1) The licensor will undertake activities that significantly affect IP to which the customer has rights. 	<p>Industry-specific guidance exists with respect to certain forms of IP licences.</p> <p>For film licences (including episodic television series in syndication) revenue is recorded when: there is persuasive evidence of an arrangement; the film is complete or available for delivery; the licence period has begun; the fee is fixed or determinable; and collection is reasonably assured.</p> <p>For music licences, revenue may be considered an outright sale when: there is a non-cancellable contract; a fixed fee; the music right and recording have been delivered; and there are no remaining significant obligations to furnish additional music. If these criteria are not met, revenue should be recognised over the remaining performance or licence period.</p> <p>For software licences (such as video games), there is a significant set of rules that require not only standard</p>	<p>IFRS does not contain any industry-specific accounting for entertainment and media entities. In general, revenue should not be recognised under licensing arrangements until performance under the contract has occurred and the revenue has been earned.</p> <p>The assignment of rights for a non-refundable amount under a non-cancellable contract permits the licensee to use those rights freely. The transaction is in substance a sale when the licence has no remaining obligations to perform.</p> <p>A fixed licence term is an indicator that the revenue should be recognised over the period because the fixed term suggests that the licence's risks and rewards have not been transferred to the customer. However, the following indicators should be considered in determining whether a licence fee should be recognised over the term or upfront: fixed or non-refundable guarantee; contract is non-cancellable;</p>

New standard	Current US GAAP	Current IFRS
<p>2) The licensee is directly exposed to the effects (whether positive or negative) of the licensor's activities.</p> <p>3) The licensor's activities do not transfer a good or a service to the customer as they occur.</p> <p>If any of the criteria above are not met, the licence is a right which transfers at a point in time, starting when the customer can direct the use of and obtain the benefits from the licence.</p> <p>Restrictions on the time period, geography or use of the IP do not affect the determination of whether or not the licence provides a right or provides access to IP. Guarantees of a valid copyright to IP should similarly not be considered in making the determination.</p>	<p>revenue recognition criteria to be achieved (for example, persuasive evidence of an arrangement) but also require vendor-specific objective evidence in order to separate any software deliverables, such as post-contract customer support (PCS).</p> <p>For other forms of licensing, there is no industry-specific guidance, so general revenue recognition rules would apply. Entities must determine whether a 'sale' (upfront) or a 'lease' (over time) model is more appropriate.</p>	<p>customer is able to exploit the rights freely; and vendor has no remaining performance obligations.</p>

Potential impact:

The accounting for licences under the new standard could significantly affect many entertainment and media entities due to the elimination of industry-specific revenue guidance. The standard establishes new criteria to determine the pattern of revenue recognition. Certain types of licence may be accelerated while others could be deferred when compared to current treatment.

An entity must first establish whether a licence is distinct from other goods and services in the arrangement before determining the pattern of revenue recognition for the licence. This identification of distinct licences may be challenging, especially when multiple licences are included in an arrangement or when a licence is offered with a service (see the 'Multiple performance obligation' section).

For many entertainment and media entities, the most challenging aspect of accounting for licences will be the assessment of whether a licence is transferring a right to use intellectual property at a point in time or is providing access to intellectual property over time. An entity needs to consider whether a customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence when it is transferred. A customer cannot obtain control if the intellectual property to which the customer has rights changes over the licence period. Effectively, the customer will be simultaneously receiving and benefiting from the ongoing transfer of such rights.

Determining whether a licence meets the relevant 'right to access' criteria may be straightforward in instances in which an entity is clearly not performing activities that affect the intellectual property as well as in instances in which the intellectual property is continually changing. The new standard provides examples of entertainment and media licences which fall into these two categories.

An example within the new standard describes the licence of a music recording to a retailer. The underlying intellectual property is decades old and it is asserted that no further activities were being performed. The conclusion of the example is that the licence is transferred at a point in time (upfront). Another example in the standard describes the licence of a sports logo to an apparel manufacturer for a fixed-fee plus a sales royalty. In this example, the underlying intellectual property is continually changing based upon the team's activities of fielding a competitive team. Further, the team has a shared economic interest with the manufacturer through a sales-based royalty. The conclusion of the example is that the licence transfers over time.

Many entertainment and media licences, including licences of music, film and television properties, will involve less clear fact patterns than these two examples. Entities will need to apply judgement to determine how their activities affect the intellectual property to which the customer has rights.

The manner in which entertainment and media entities monetise intellectual property could contribute to the challenge of these judgements. Many entities license content to multiple distribution platforms, such as cable outlets, broadcasters, and online distributors. The performance of the content within each ‘window’ of exploitation can affect its value to the licensor and the licensee. Therefore, there are incentives for licensors to continue to support their intellectual property throughout its useful life, through developing complementary content or through promotional activities targeted at end consumers or other licensees. The level of such activities may vary significantly depending upon the nature of the intellectual property, its age, and the business model of the licensor. The revenue standard does not include any additional guidance on either the type or extent of activities that would be considered sufficient to significantly affect the intellectual property during the licence period and therefore affect the pattern of revenue recognition. While not determinative, a shared economic interest could create an incentive for the licensor to undertake additional activities. Entities will need to develop a methodology to identify and then analyse their relevant activities in relation to the rights granted to licensees, including whether the customer is exposed to the effects of the activities and whether they result in additional distinct goods or services being transferred.

It might be difficult for some entities that grant a significant number of licences to perform a robust analysis on a licence-by-licence basis. To the extent licences within a certain category or type are structured similarly with similar activities undertaken by the licensor, it may be appropriate to consider such licences together as a portfolio as long as results would not differ materially from a licence-by-licence assessment.

As stated above, the following are *not* considered when determining whether a licence represents access over time or a right transferred at a point in time:

- Restrictions, such as for time, geography or use, as such restrictions are merely aspects of the rights that are transferred.
- Guarantees of a valid copyright to intellectual property.

Many industry licences include restrictions on time, geography or use. For example, a studio may license rights that permit a cable channel to exhibit a film up to five times over the next two years. These restrictions do not affect whether the licence transfers at a point in time or over time, but are aspects of the right transferred. Entities will need to take care to identify distinct performance obligations before applying this concept. For example, if the studio licensed five separate films to be exhibited over the same two-year period, the transfer of the rights to each film would likely be separate performance obligations. An entity would need to evaluate each performance obligation separately to assess the timing of recognition. Licence revenue should not be recognised until the licensee can benefit from the rights that have been transferred, whether at a point in time or over time.

For both licences recognised at a point in time and those recognised over time, sales- or usage-based royalties related to licences of intellectual property cannot be recognised before the underlying sales or usages occur (see the ‘Variable consideration’ section).

Current US GAAP provides entertainment and media industry-specific guidance for licence transactions not only with respect to the timing of recognition but also with respect to various other concepts such as the treatment of cross-collateralised film deals, music licences for new and library content, contingent royalties, the fair value of software-related deliverables and film licence modifications. The new standard has no industry-specific guidance, and furthermore, the guidance on licences only addresses the timing of recognition and treatment of sales-based royalties as discussed above. An entity will generally need to apply the other steps of the standard (identifying the contract, identifying distinct performance obligations, determining the transaction price, and allocating the price to distinct obligations) to determine the appropriate accounting for its licence arrangements just as it would for non-licences.

Multiple performance obligations

The new revenue standard requires entities to identify all of the promises in a contract and to determine whether those obligations 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 standard	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 entity’s promise to transfer the good or service to the customer is separable from other promises in the contract.</p>	<p>An entity should identify all deliverables in an arrangement and then make a determination of the appropriate unit of account based upon the deliverables that have stand-alone value.</p>	<p>An entity 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 stand-alone selling prices. If a stand-alone selling price is not available, management should make an estimate of it maximising the use of observable inputs.</p>	<p>Arrangement consideration is allocated to separate units of account based upon relative selling price.</p> <p>For software transactions, relative selling price can only be determined by vendor-specific objective evidence (VSOE).</p> <p>For non-software transactions, objective evidence must be used if available. Otherwise, the entity’s best estimate of selling price is used.</p> <p>At any point in time, amounts recognised in a multiple-element transaction are limited to that which is not contingent on future deliverables.</p>	<p>When elements in a single contract are accounted for separately, fair value should be used in allocating the transaction price to the separate elements.</p>

Potential impact:

Identifying distinct obligations

Entities might identify different performance obligations under the new standard 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 that will require assessment to determine if there is more than one performance obligation:

- Distribution agreements that provide customers with different services over the subscription period.
- Marketing deals that deliver advertising to customers across several platforms and time periods.
- Licensing arrangements that provide access to library content as well as future output.
- The licence 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, an entity will first need to determine if a customer can benefit from a good or service on its own or together with resources readily available to it. The entity will then need to determine if the 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 judgement, as the entity must also determine whether it meets any of the following criteria to determine if a promise can be separated from other promises in the contract:

- Whether the entity 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 customises 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.

Within the entertainment and media industry, these judgements may become more challenging with the growth of digital business models and the proliferation of on-demand streaming services and other emerging platforms.

Allocating transaction price

Allocating the transaction price across all of the obligations in an arrangement could differ from current practice in certain circumstances. The revenue standard eliminates 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 entities need to allocate revenue to free or discounted products or services that are provided in a contract, even if payment 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 subsequent spots billed at a higher rate. Under current US GAAP, no amounts are allocated to the free front-end services, even if these spots have stand-alone value, since all consideration is contingent on providing the spots in the future. Under the new standard, the transaction price for the entire arrangement will be allocated to each of the spots based upon relative stand-alone selling price.

The stand-alone selling price of a good or service must be estimated if it is not sold on a stand-alone basis. The new standard allows for several alternatives that can be used to form estimates of relative selling price. This flexibility is most clear in relation to software transactions (including video games). An entity will no longer be required to demonstrate vendor-specific objective evidence (VSOE) of fair value in bundled software arrangements in order to separately account for licences as is currently required under US GAAP, aligning the guidance more closely with IFRS.

Example - Online functionality included with a video game

Facts: VideoCo develops and sells video games for C50. The video game can be played on its own, but VideoCo includes additional services that enhance the user experience by hosting multi-player game formats and other online services for no additional cost to the customer. The additional services are not sold on a stand-alone basis by VideoCo.

How many performance obligations should VideoCo identify in this arrangement?

Discussion: The user can play the game in single-player mode without regard to the multi-player functionality. Therefore, the customer can benefit from each item on its own.

VideoCo next assesses whether the game and the online functionality are distinct within the context of the contract. This determination requires more judgement. VideoCo will need to assess the extent to which it is performing a service of integrating the game with the online services and the dependency of the game on such services to determine whether the game is distinct from the online services.

If VideoCo concludes that the game and the services are separable, it will allocate the C50 transaction price to each performance obligation based on their estimated relative stand-alone selling prices (VSOE would not be needed). VideoCo would recognise revenue as each of the performance obligations is satisfied. If the obligations are not separable, the transaction price is recognised over the combined service period.

Upfront fees for activation services

Cable television entities often charge customers an activation or installation fee at the inception of a monthly subscription service. Cable television entities follow specific accounting guidance under current US GAAP that allows upfront installation fees to be recognised as revenue to the extent of direct selling costs (which differs from IFRS). The new standard removes this industry-specific guidance. All entities (including cable television entities) will need to determine if a distinct good or service is transferred to the customer at the inception of the arrangement to determine if revenue should be recorded at that time, similar to IFRS today.

Options to acquire additional goods or services

An entity may grant a customer an option to acquire additional goods or services in conjunction with a current transaction. Such options may provide a discount on subsequent purchases or the ability to extend or renew the agreement. Licensors will need to determine if the option gives the customer a material right to determine the appropriate accounting.

New standard	Current US GAAP	Current IFRS
<p>An option to acquire additional goods or services gives rise to a separate performance obligation if the option provides a material right to the customer that the customer would not receive without entering into that contract. Management will need to estimate the transaction price to be allocated to the option based on its estimated stand-alone selling price as, in effect, the customer is paying for future goods or services to be received. Revenue is recognised for the option when it expires or when the future goods or services are transferred to the customer.</p> <p>An option to acquire additional goods or services at a price within a range of prices typically charged for those goods or services is not a material right even if the option can only be exercised because of entering into the previous contract. Such an option is considered a marketing offer.</p>	<p>Guidance exists within software accounting standards that a discount offered on future purchases must be assessed to determine if it is significant and incremental to discounts that are normally offered to customers. If there is a significant and incremental discount, it represents a deliverable under the arrangement.</p> <p>For non-software transactions, predominant practice is to follow the software model by analogy (except that VSOE of fair value is not required).</p>	<p>If an entity grants its customers, as part of a sales transaction, an option to receive a discounted good or service in the future, it accounts for that option as a separate component of the arrangement and allocates consideration between the initial good or service provided and the option.</p> <p>Entities often analogise to the accounting for customer loyalty programs and defer revenue related to significant options and recognise it only upon redemption.</p>

Potential impact:

Many options to renew or extend agreements in the entertainment and media sector are at constant or escalating prices, mitigating the potential that an option represents a material right. However, to the extent an option includes discounted offers or appears to be a material bargained-for future discount to the customer, an entity will need to consider whether the option is a distinct performance obligation in the arrangement.

Examples of potential options to consider in the entertainment and media sector include:

- **Option to renew a television series** – A studio may develop an episodic television series for a network with an agreement to license the first season for a set price in addition to granting the network a fixed-price option to renew the series for an additional two seasons. The studio will need to assess whether granting a fixed-price option provides a material right to the network, since a returning show may have a higher value in subsequent seasons than in the initial season.
- **Option to extend a subscription agreement** – A publisher of periodicals may offer a customer a subscription for a 12-month period with an option to extend the subscription at any point for a lower issue price. The publisher will need to assess whether the option represents a material right that is a separate performance obligation or a marketing offer within the normal range of prices charged to subscribers.
- **Option to purchase additional advertising** – A broadcaster may reach an agreement to sell to an advertiser 100 advertising spots at various points over the next year at a fixed price, along with an offer for an additional 50 advertising spots at the same per-spot price at the advertiser's sole option. This option could provide a material right to the advertiser since it protects them from increases in advertising rates during the year (that is, 'scatter market' pricing). However, it will not provide a material right if the price charged is in the range of rates currently being offered in the same time period.

Variable consideration

The transaction price is the amount of consideration that an entity expects to be entitled to in exchange for transferring promised goods or services to a customer. The transaction price might include an element of consideration that is variable or contingent upon the outcome of future events, including (but not limited to) discounts, rebates, refunds, credits, incentives, performance bonuses and royalties.

Variable consideration is common in many forms in the entertainment and media sector. Examples include sales- or usage-based royalties, price protection offered on home entertainment DVD sales, cumulative volume discounts offered to significant advertisers, and performance bonuses on marketing contracts.

New standard	Current US GAAP	Current IFRS
<p>Variable consideration should be estimated and included in the transaction price to the extent that it is highly probable (IFRS) or probable (US GAAP) that a significant subsequent reversal in the cumulative amount of revenue recognised will not occur if estimates of variable consideration change.</p> <p>An exception is provided for revenue recognised from sales- or usage-based royalties on licences of intellectual property. Royalties from licences of IP</p>	<p>Revenue is only recognised when it is fixed or determinable and when collection is reasonably assured.</p> <p>Royalty revenue is generally recorded in the same period as the sales that generate the royalty payment.</p>	<p>Revenue is recognised when it is probable that economic benefits will flow to the entity and the amount of revenue can be measured reliably.</p> <p>Revenue from royalties accrues in accordance with the terms of the relevant agreement and is usually recognised on that basis unless it is more appropriate to recognise revenue on some other systematic basis.</p> <p>Revenue is recognised for a licence fee contingent on the occurrence of a</p>

New standard	Current US GAAP	Current IFRS
are not included in the transaction price until the subsequent sale or usage occurs, and the related performance obligation has been satisfied (or partially satisfied).		<p>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 recognised when the licence is available for exploitation if the licence fee or royalty is probable of being received and is reliably measurable.</p>

Potential impact:

Sales- or usage-based royalties on licences of IP

The IASB and FASB decided on an exception relating to variable consideration for sales- or usage-based royalties of licensed intellectual property. Such royalties from licences of intellectual property are not included in the transaction price until the underlying contingency is resolved. This exception means that the treatment of many contingent royalty transactions will remain consistent with current practice under both IFRS and US GAAP.

An entity will need to consider whether an arrangement includes a sales- or usage-based royalty on licences of intellectual property in order to apply the exception. A sale of intellectual property does not qualify for the exception. The exception also does not apply if intellectual property is bundled with a tangible good (such as a physical book) and is not distinct from the tangible good.

Other forms of variable consideration

Variable consideration is common in the entertainment and media sector beyond just sales- or usage-based royalties. An entity estimates variable consideration based upon either the expected value (the sum of probability-weighted amounts) or the most likely value (the single most likely result). An entity must use the method that best predicts the variable consideration in the circumstances.

Factors to consider when determining whether it is highly probable (IFRS) or probable (US GAAP) that a significant reversal of revenue will not occur include the length of time of any underlying uncertainty, the experience of the entity with similar transactions, and the range of possible consideration amounts. An entity that is currently deferring revenue from certain transactions pending the resolution of a price contingency may be able to recognise revenue earlier under the new standard if there is a minimum amount that can be estimated that is probable of not having a significant revenue reversal in the future.

An advertising agency that earns performance bonuses on marketing contracts will be required to estimate the bonuses to be achieved when recognising revenue as marketing service performance obligations are fulfilled. In situations where an entity receives either all of the bonus or none of it, an entity might conclude that the most likely value is the better method since the bonus is either received in full or not at all. 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 was probable or highly probable that a significant reversal of revenue would not occur.

Similar analysis would be required for other forms of industry variable consideration including adjustments to advertising contracts for audience shortfalls, adjustments to cable carriage rates upon triggering a most-favoured-nation clause, and price protection that is offered on home entertainment DVD sales.

Return rights

Return rights are common in sales transactions that include physical goods sold to retailers. Some of these rights may be articulated in contracts with customers or distributors, while some are implied during the sales process or based on customary business practice. Return rights are commonly granted by book publishers and print media as well as film and music producers with respect to DVDs and CDs.

New standard	Current US GAAP	Current IFRS
<p>Revenue should not be recognised for goods expected to be returned; rather, a liability should be recognised for the expected amount of refunds to customers. The refund liability should be updated each reporting period for changes in expected refunds. An asset and corresponding adjustment to cost of sales should be recognised for the right to recover goods from customers on settling the refund liability, with the asset initially measured at the original cost of the goods.</p> <p>Returns reserves should be determined using the guidance for variable consideration, including the constraint that revenue should only be recognised for the amount that is probable of not resulting in a significant cumulative revenue reversal if estimates change.</p>	<p>Revenue from sales transactions with a right of return should be recognised at the time of sale if several conditions are met (for example, price is fixed or determinable, or buyer is obligated to pay) and a reasonable estimate of returns can be established, typically only possible with a large volume of relatively homogeneous transactions.</p>	<p>Revenue is typically recognised at the gross amount (in full) with a provision recorded against revenue for the expected level of returns, provided that the seller can reliably estimate the level of returns based on an established historical record and other relevant evidence.</p>

Potential impact:

Accounting for returns under the new standard is similar to current practice, but differences exist that entities will need to consider.

The balance sheet will need to reflect the entire refund obligation as a liability and will include an asset for the right to the returned goods. When a significant portion of returns is expected (for example, some newsstand sales), this change in presentation could result in a significant gross-up of the balance sheet as compared to current practice.

Estimates of sales returns may also be different than under current practice. For instance, under current US GAAP, if a publisher is not able to form reasonable and reliable estimates of returns, all revenue is deferred until better estimates of returns can be made. This may not be until the retailer reports that it has sold the goods to the end customer. The new standard requires that an estimate of returns be made to the extent that the cumulative amount of revenue recognised is not probable of a significant reversal. This could result in the recording of a minimum amount of revenue upon sale to the retailer even when an estimate of total revenue is not reliable.

Example - Sale of physical product by a publisher

Facts: A publisher sells 100 copies of Book A for C10 each. The books cost C2 to produce and include a return right. The retailer takes physical possession of the books and is contractually obligated to pay for the inventory once the books are received. The estimated sales returns associated with this transaction are 30% based on historical return patterns. The publisher estimates that the costs of recovering the products will be insignificant and expects the returned products can be resold at a profit.

How should the publisher account for the sale of Book A?

Discussion: Once control transfers to the retailer, C700 of revenue (C10 x 70 products (100 less the 30% expected returns)) and cost of sales of C140 (C2 x 70 products) should be recognised. An asset of C60 (30% of product cost) will be established for the anticipated sales returns, while a liability of C300 (30% of product sale price) is established for the refund obligation. The effect of anticipated returns on inventory is presented on a gross basis rather than being offset against accounts receivable. The estimate of returns is re-evaluated at each reporting date. Any changes in estimated returns will require an adjustment to the corresponding asset and liability.

Barter transactions

Several entertainment and media subsectors engage in barter transactions, typically exchanging advertising for advertising, goods or services. The new standard could change how the transaction price is measured in some situations.

New standard	Current US GAAP	Current IFRS
<p>Revenue is recorded at the fair value of cash and non-cash consideration received or promised from the customer. The fair value is measured at the earlier of receipt of the non-cash consideration by the entity or when (or as) the entity satisfies its performance obligations. If an entity is unable to reasonably estimate the fair value of the non-cash consideration, it should measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer in exchange for the consideration.</p>	<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 entity'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, non-monetary transactions should be 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 recognised in an exchange of similar goods or services. However, if the medium of advertising exchanged is dissimilar in nature, revenue is recognised 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:

Non-cash consideration should be recorded at fair value similar to current accounting. However, an entity must first look to the value of the good or service received as opposed to the good or service surrendered. This represents a change from current US GAAP that aligns with current IFRS.

The new revenue recognition guidance has no specific guidance for advertising-for-advertising transactions, so additional judgement may be necessary to determine the fair value of such transactions when there is a limited market. Recognition is no longer precluded in the absence of cash-based transactions from others for similar advertising.

Principal versus agent

The determination of whether an entity is a principal or an agent will continue to require significant judgement. The principal/agent determination drives whether revenue is recorded on a gross or a net basis and therefore it significantly affects the amount of revenue recognised for many entertainment and media entities.

New standard	Current US GAAP	Current IFRS
<p>An entity is a principal in an arrangement if it obtains control of a good or service before transferring it to a customer. Obtaining title momentarily before transferring a good or service to a customer does not necessarily constitute control.</p> <p>An entity is an agent if its obligation is to arrange for another party to provide goods or services.</p> <p>Factors that may indicate that an entity is an agent, and therefore does not control a good or service before transferring to a customer, include:</p> <ul style="list-style-type: none"> • Another entity is responsible for fulfilling the contract. • The entity does not have inventory risk. • The entity does not have pricing latitude. • The entity earns a commission. • The entity does not have credit risk. 	<p>The determination of whether an entity is a principal or an agent is based on the following factors:</p> <ul style="list-style-type: none"> • Is the entity the primary obligor in the arrangement? • Does the entity have general inventory risk? • Does the entity have latitude in establishing pricing? • Does the entity change the good or service? • Is the entity involved in supplier selection? • Is the entity involved in determining product specifications? • Does the entity have physical inventory risk? • Does the entity have credit risk? <p>The first three factors above are considered to be weighted more heavily than the other factors.</p>	<p>An entity is a principal if it is exposed to risks and rewards when selling goods or providing services.</p> <p>Indicators that an entity is acting as a principal in an arrangement are:</p> <ul style="list-style-type: none"> • The entity is the primary obligor. • The entity has inventory risk. • The entity has pricing latitude. • The entity has credit risk. <p>An indicator that an entity is an agent is if the entity earns a pre-determined fee.</p>

Potential impact:

Entities will use many of the same criteria used today to determine if they should record revenue on a gross or net basis. However, as compared to US GAAP, the standard has fewer criteria and no longer weights some factors more than others. The purpose of the indicators under the new standard is to determine if the entity obtained control of a good or service before transferring to the customer.

Principal versus agent determinations are common in the entertainment and media industry. For example:

- Determining if a publisher or a website is the principal with respect to the sale of an electronic book to a consumer.
- Determining if a producer or distribution studio is the principal with respect to film exploitation revenue.
- Determining if an internet advertiser or an agency is the principal in an advertising transaction.

These judgements appear to be increasing in number and significance with the growth of digital business models which often involve no physical goods and little inventory or credit risk.

Entities will need to reconsider the appropriate accounting for these and other transactions with respect to the modified criteria in the new standard.

Deferral of costs

Impact on current deferred or capitalised costs

Existing US GAAP currently includes a substantial amount of guidance related to the capitalisation of costs specific to many entertainment and media subsectors, principally related to the cost of developing content. Such industry-specific guidance does not exist in IFRS, so IFRS entities follow the guidance for inventory or intangible assets to reach conclusions on capitalisation and amortisation.

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

Impact on other costs to obtain or fulfil a contract

Incremental costs to obtain a contract will be capitalised if they are expected to be recovered. Such costs may be expensed as incurred as a practical expedient if the amortisation period of the asset is one year or less. This could result in additional deferred costs for certain subscription-based businesses which incur a commission or agency cost at the time of signing up a long-term subscription.

Costs incurred to fulfil a contract should be assessed to determine if the accounting for those costs is in the scope of other standards. Costs incurred to fulfil a contract that are not in the scope of other standards are recognised as an asset under the new standard if the costs relate directly to a contract, generate or enhance resources of the entity that will be used to satisfy future performance obligations, and are expected to be recovered. Costs capitalised under the new standard will be amortised as control of the goods or services to which the asset relates is transferred to the customer. As discussed above, many costs to fulfil a contract are currently covered by other guidance within the entertainment and media space. The new deferral rules may apply in certain instances to producers that construct assets for studios or other users on a contract basis.

About PwC's Entertainment and Media practice

PwC's Global Entertainment and Media practice works with businesses to address both the challenges and opportunities presented by digital transformation, assisting them shift from traditional business models to businesses, brands and revenue streams that leverage digital content and platforms. We work with clients across a wide range of key industry sectors including: television, film, music, Internet, video games, advertising, publishing, radio, out of home advertising, sports, business information, casino gaming and more.

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 184,000 people who are committed to delivering quality in assurance, tax and advisory services.

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Questions?

PwC clients who have questions about this *In depth* should contact their engagement partner. Engagement teams that have questions should contact members of the Revenue team in Accounting Consulting Services.

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