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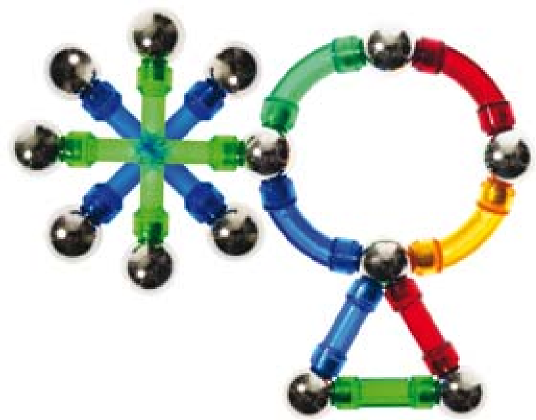

IASB issues revised exposure draft on revenue recognition – insights for the media industry

The revised ED is the next step in developing an entirely new revenue recognition standard and follows extensive outreach and redeliberations on the proposals in the original ED issued in June 2010.

On 14 November 2011, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) jointly issued a re-exposure draft ED/2011/6 *Revenue from Contracts with Customers* ('the revised ED'). The revised ED is the next step in developing an entirely new revenue recognition standard and follows extensive outreach and redeliberations on the proposals in the original ED issued in June 2010. Although the underlying conceptual basis is unchanged, the IASB and the FASB (collectively 'the Boards') changed many detailed aspects of the original ED's proposals. As a result of these changes and the importance of the revenue line item to users of financial statements, the Boards decided to expose for public comment a revised ED. The comment period ends on 13 March 2012. The effective date of the proposed standard will not be earlier than for annual reporting periods beginning on or after 1 January 2015, with the IASB permitting early application.

This IFRS Industry Insight publication highlights aspects of the revised ED that may affect media entities and provides insight to assist in the assessment of the potential impact of these revised proposals.

Identifying multiple performance obligations

Both the original and revised EDs propose that a good or service would be accounted for as a separate performance obligation if it is deemed 'distinct'. The revised ED refines the definition of 'distinct' and, except as explained below, a good or service is distinct if either of the following criteria is met:

a) the entity regularly sells the good or service separately; or

b) the customer can benefit from the good or service either on its own or together with resources that are readily available to the customer.

Notwithstanding those criteria, a good or service in a bundle of promised goods or services is not distinct, and therefore the bundle of goods or services would be treated as a single performance obligation, if both of the following criteria are met:

a) the goods or services in the bundle are highly interrelated and transferring them to the customer requires the entity also to provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted; and

b) the bundle of goods or services is significantly modified or customised in order to fulfil the contract.

The revised proposals note that, as a practical expedient, an entity may account for two or more distinct goods or services as a single performance obligation if those goods or services have the same pattern of transfer to the customer.

The proposal to restrict the circumstances in which a bundle of goods or services can be treated as consisting of separate performance obligations may have an effect on some media entities. A media entity that enters into a contract to provide various advertising deliverables such as print, television and internet advertisements or provides both print and electronic/online products may need to consider whether the contract contains multiple performance obligations based on the above criteria.

If these options provide a material right to the customer that it would not receive without entering into that contract (i.e., an incremental right), then the revised ED proposes that these options would give rise to separate performance obligations.

Example 1

A media entity provides multiple forms of advertising to customers, including print and electronic advertising in both stand-alone and in bundled arrangements. The entity enters into a contract with a major retailer to provide two advertising campaigns. The entity will provide the advertisements at different points in time – six print advertisements in its bi-monthly magazine run and 50,000 click-through advertisements on its website during the one year contract term. The total transaction price is CU200,000. The entity will need to assess whether the print advertisements and electronic advertisements should be accounted for separately. As the advertising campaigns are regularly sold separately by the entity and are delivered at different points in time, they would be considered distinct and as such, the transaction price of CU200,000 should be allocated to each advertising campaign based on their relative stand-alone selling prices.

Example 2

A media entity provides two different forms of delivery of its content to customers – print and online. A customer can choose to enter into a contract for a 12-month subscription to receive the print version, the online version, or both. A customer can purchase the print and online versions separately or as a package for CU150. The media entity will need to assess whether the print version and online subscription are distinct. The print version would be distinct from the online version because they are sold separately and are delivered at different points in time. Therefore, for those contracts that are sold as a package, the media entity would need to allocate the transaction price of CU150 between the print version and the online version.

Example 3

A media entity provides a 12-month online subscription to its content for CU150. The online subscription provides a customer the right to access an archive of previous content as well as a promise to make new content available. The media entity will need to assess whether access to the archive and the promise to make new content available online are distinct. The entity's obligations to provide access to the archive and to provide new content would be considered distinct if the customer can benefit from each service on its own. Both performance obligations are satisfied over time. If both performance obligations have the same pattern of transfer, the entity may use the practical expedient to account for these distinct services as a single performance obligation.

Customer incentives

Some media entities offer a variety of customer incentives (e.g., rebates, coupons, buy one get one free products, contract renewal options, and discounts on future goods and services). Some of these incentives may include options to acquire additional goods or services. If these options provide a material right to the customer that it would not receive without entering into that contract (i.e., an incremental right), then the revised ED proposes that these options would give rise to separate performance obligations. In essence, the customer is paying the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option rights expire.

Media entities providing incentives that are considered separate performance obligations will need to allocate the transaction price to each performance obligation (including options) on a relative stand-alone selling price basis. Where the relative stand-alone selling price for the option is not directly observable, the entity should estimate it and the estimate should reflect the discount the customer would obtain when exercising the option, adjusted for:

a) any discount that the customer could receive without exercising the option; and

b) the likelihood that the option will be exercised.

The revised proposals note that, as a practical alternative, an entity may allocate the transaction price to the optional future goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration where such goods and services are similar to the original goods or services in the contract (e.g., contract renewal options).

Media entities would need to assess carefully the impact of customer incentives (if they constitute a material right) on their analysis of performance obligations in a contract because the identification of performance obligations and subsequent allocation of the transaction price may affect the timing of revenue recognition and how much revenue is recognised.

A media entity would estimate the transaction price using either a probability-weighted estimate or the most likely amount of cash flows expected from the transaction, depending on which is the most predictive of the amount to which the entity would be entitled.

Example 1

A publisher enters into a contract with a customer for the sale of a book for CU20. As part of the contract, the publisher provides that particular consumer with a 50 per cent discount coupon for the future purchase of a digital version of the book in the following month (the digital version of the book also costs CU20). The publisher placed advertisements in the local newspapers, offering free 10 per cent discount vouchers on future purchases of any digital versions of its books as part of its seasonal promotion in the following month. (Only one coupon can be used per purchase.) Hence, the discount that is incremental (40 per cent) would be considered a material right. The publisher would account for the incremental discount as a separate performance obligation in the contract for the sale of the book. To allocate a portion of the transaction price to the separate performance obligation for the discount coupon, the publisher estimates the probability of redemption to be 70 per cent. As such, the publisher's estimated stand-alone selling price of the discount coupon is CU5.60 (70% likelihood of exercising the option x CU20 selling price x 40% incremental discount). The publisher will allocate CU4.38 (CU20 x [CU5.6/(CU5.6+CU20]) of the CU20 transaction price to the discount coupon. Upon the sale of the book, the publisher will recognise revenue of CU15.62 and defer recognition of the discount coupon of CU4.38 until the coupon expires or is redeemed.

Example 2

A media entity produces a television series and enters into a contract to license one season of 24 episodes to a network for CU1.0 million per episode. The network is provided with an option to renew the contract for an additional season at a cost of CU1.5 million per episode. The media entity will need to assess whether the option to renew the contract at a fixed price per episode is a material right. The network would not receive the option without entering into that contract. Additionally, the value of that fixed-price option could be significant if the series is successful because without the option, the price for a second season may be greater than CU1.5 million per episode after a successful first season.

Determining the transaction price

The original ED proposed that if the transaction price is subject to variability, an entity would be required to use a probability-weighted estimate of the transaction price if such an estimate can reasonably be made. The revised ED clarifies that "the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties." The transaction price would include discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, concessions and other similar items. The estimation would reflect available historical, current and forecast information and would be based on either the probability-weighted amount or the most likely amount (i.e., management's best estimate), "depending on which method the entity expects to better predict the amount of consideration to which it will be entitled." One method would need to be applied consistently throughout the contract.

Discounts are often receivable by a customer when specified cumulative levels of purchases are achieved. A media entity would estimate the transaction price using either a probability-weighted estimate or the most likely amount of cash flows expected from the transaction, depending on which is the most predictive of the amount to which the entity would be entitled. The estimate of cash flows would include the entity's expectation of future discounts. If an entity receives consideration from a customer and expects to refund some of that consideration because of discounts, a liability would be recognised for the amount that the entity expects to refund. Likewise, if a customer is required to pay additional consideration to an entity if specified performance metrics are met, the estimate of cash flows would include the entity's expectation of additional consideration. As discussed later in this publication, the revised ED deals with uncertainty over variable consideration by imposing a cumulative cap on the amount of revenue recognised, rather than by restricting the estimate of the transaction price.

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Sales with a right of return

It is common for some media entities to transfer control of products (e.g., books, DVDs, CDs) to retailers or consumers along with rights to return the products for a variety of reasons. If the retailers or customers return their purchases, they may be entitled to a refund, store credit or exchange. The revised ED proposes that the entity should account for the transfer of products with a right of return by recognising:

a) revenue for the transferred products in the amount of consideration to which the entity is reasonably assured to be entitled (taking into consideration the products that are expected to be returned);

b) a refund liability; and

c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

This is similar to existing guidance. Exchanges by consumers for like for like products are not considered returns and returns of defective products are assessed under the warranty requirements under the revised proposals.

Example

A media entity sells a retailer 600 DVDs for CU20 each. The cost of each DVD is CU10 and the entity's customary business practice is to allow a retailer to return the product within 30 days and receive a full refund. To determine the transaction price, the entity decides that the approach that is the most predictive of the amount of consideration to which the entity will be entitled will be to use the most likely amount. Using the most likely amount (based on historical sales patterns), the entity estimates that 5% of the products will be returned. The entity's experience is predictive of the amount of consideration to which the entity will be entitled. The entity estimates that the costs of recovering the DVDs will be immaterial and expects that the returned DVDs could be resold at a profit.

At the point of sale, the entity would recognise revenue of CU11,400 [CU20 x 570, based on an expectation that 30 DVDs (600 x 5%) will be returned] and cost of sales of CU5,700 [CU10 x 570 DVDs]. A liability for CU600 (5% of the sale price, or CU20 x 30 DVDs) is established for the refund obligation and an asset of CU300 (5% of product cost, or CU10 x 30 DVDs) is recognised for the entity's right to recover the DVDs from customers on settling the refund liability. The probability of return is evaluated at each subsequent reporting date and any changes in estimates are reflected through adjustments to the asset and liability and to revenue and cost of sales.

Recognising revenue as performance obligations are satisfied

The original ED introduced the concept of 'control' in the determination of when a good or service transfers to a customer and, thus, when revenue is recognised, which may be at a point in time (e.g., delivering a good) or continually over a period (e.g., rendering a service). The original ED provided specific indicators for analysing the transfer of control at a point in time and specified that control may be transferred continuously. Following comments on the original ED, the Boards decided to modify the proposed indicators of when a customer obtains control at a point in time and provide additional guidance that an entity must consider in determining whether control transfers continuously over time (including clarifying how an entity should measure its progress towards completion of a performance obligation that is continuously satisfied).

The revised ED carries forward most of the proposed guidance in the original ED but describes the concept of control instead of specifically defining it, removes the indicator of control that states that the design or function of the good or service is customer-specific and adds 'risks and rewards of ownership' as an indicator of control. Indicators that the customer has obtained control of the good or service include:

- the entity has a present right to payment for the asset;
- the customer has been transferred legal title to the asset;
- the entity has transferred physical possession of the asset;
- the customer has significant risks and rewards of ownership of the asset; and
- the customer has accepted the asset.

The revised ED also notes that for an entity to recognise revenue over a period, it must conclude that a performance obligation is continuously satisfied. It must then select a method to measure progress toward completion.

If an entity grants a licence to a customer, the promised right gives rise to a performance obligation that the entity satisfies when the customer obtains control and can use and benefit from the right.

An entity satisfies a performance obligation continuously if at least one of the following criteria is met:

1. The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced (e.g., the customer controls the work-in-progress).

2. The entity's performance does not create an asset with 'alternative use' to the entity (e.g., the contract does not allow the entity to sell the work-in-progress to another customer or the work-in- progress is highly customer-specific and would not be suitable for another customer) and at least one of the following criteria is met:

   a) The customer simultaneously receives and consumes a benefit as the entity performs each task;

   b) Another entity would not need to substantially re-perform the work completed to date if that other entity were to fulfill the remaining obligation to the customer (without having access to work-in-progress, or any other asset, controlled by the entity); or

   c) The entity has a right to payment (assuming that the seller complies fully with its contractual obligations) for performance completed to date and expects to fulfill the contract as promised. If the customer cannot cancel the contract, or the full contract price is payable on cancellation, this would appear to meet the criteria. If the contract can be cancelled by the customer and a fixed amount is payable on cancellation, which is lower than the total contract price, this may not be considered to be sufficient to compensate for performance to date and therefore may not satisfy this criterion.

For the sale of licences, media entities will need to pay particular attention to the point in time when a customer can benefit from those rights. Although the rights may transfer to the customer, a restriction may exist on when the customer can use the rights. Such restrictions may result in a delay in the recognition of revenue because the customer would not have the ability to direct the use of and benefit from the rights until the restriction lapses.

For the sale of media services such as cable and satellite programming, advertising and access to online publishing, media entities will need to carefully assess their contractual arrangements to determine whether control transfers to a customer over time or at a point in time. For those services where control is transferred over a period of time, the entity will need to determine the appropriate input or output method to measure progress toward completion.

Sell-through arrangements

Some entities in the media industry use a sell-through arrangement where they deliver products (e.g., magazines, newspapers) to another party (e.g., distributor) for sale to the end customer. Under current guidance, revenue is typically only recognised when the products are sold to the end customer (as the risks and rewards of ownership may not be transferred until this point if the media entity has the ability to recall or transfer unsold products).

Under the proposals of the revised ED, entities will need to assess the terms of their sell-through arrangements to determine when control of the products has transferred. If the distributors have control of the products, including a right of return at their discretion, control transfers when the products are delivered to them. Entities that currently base their revenue recognition policy solely on a transfer of risks and rewards criterion may be affected. Although the transfer of risks and rewards is one indicator of whether control has transferred, the revised proposals include additional criteria that need to be considered. For example, if the entity is able to require the distributor to return the product, or the distributor does not have an obligation to pay for the products, then control has not transferred to the distributor. As such, revenue would only be recognised when the products are sold to a third party.

Example

A media entity has a one-year contract with a distributor to supply magazines that will be sold to end customers. The entity has the right to sell unsold product to another distributor. The entity has no further obligations and the distributor has no further return rights after the product is sold to the end customer. As the distributor does not have to pay the entity until there is a sale to the consumer and the entity has the right to sell any unsold product to another distributor, control has not transferred. As such, revenue would only be recognised once the product is sold to the end customer.

Licences and Royalties

Some media entities may grant licences to a customer to produce products using their intellectual property (e.g., a brand name, the right to use a character in products or certain markets and the rights to broadcast a film). If an entity grants a licence to a customer, the promised right gives rise to a performance obligation that the entity satisfies when the customer obtains control and can use and benefit from the right.

The revised ED imposes a constraint on the cumulative amount of revenue recognised, being that this should not exceed the amount to which the entity is reasonably assured to be entitled.

Example

A studio licenses broadcast rights for a film to a customer for CU16 million on an exclusive basis in a specific geographic area for a six-year period which is paid based on the following schedule: CU12 million on theatrical availability, CU3 million one year after the theatrical release date (when home videos also become available) and CU1 million two years after the theatrical release date (when television broadcast also becomes available). The contractual arrangement prevents the studio from licensing the film to other customers in the specified geographic area during the six-year term. The customer had a choice to purchase the film rights for any of the three releases separately or as a package. In determining how to account for the licence fee revenue, the studio will need to assess if it is providing a single six-year licence covering theatrical, home video and television releases (i.e., a single performance obligation) to the customer or whether it is providing three distinct licences (i.e., separate licences for theatrical release, home video release and television release). The entity concludes that the different releases are distinct and the transaction price of CU16 million should be allocated to each release on their relative stand-alone selling price. The respective allocated revenue for each release would be recognised once the customer obtains control and can use and benefit from the rights to broadcast for a specific release under the terms of the arrangement. Although the broadcast rights transfer to the customer, restrictions exist on when the customer can broadcast the various releases. Such restrictions may result in a delay in the recognition of revenue because the customer does not have the ability to direct the use of and benefit from the various releases until the restrictions lapse.

Constraining the cumulative amount of revenue recognised

The revised ED imposes a constraint on the cumulative amount of revenue recognised, being that this should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met:

- the entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities); and
- the entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.

Notwithstanding the requirements above, the revised ED notes that if an entity licenses intellectual property to a customer and the customer promises to pay an additional amount of consideration that varies on the basis of the customer's subsequent sales of a good or service (e.g., a sales-based royalty), the entity would not be reasonably assured to be entitled to the additional amount of consideration until the uncertainty is resolved (i.e., when the customer's subsequent sales occur).

Example 1

A media entity enters into a licence agreement with a manufacturer for five years. Under the agreement, the manufacturer agrees to pay CU1 for each product it manufactures and sells using the entity's intellectual property. The manufacturer will provide this data to the entity at the end of each quarter. After transferring the licence to the manufacturer, the entity does not have any remaining performance obligations.

The cumulative amount of revenue recognised by the entity during the year is limited to the quarterly sales or usage based royalties regardless of any experience the entity may have with similar contracts because the ED states that, in respect of royalties from licensing intellectual property, amounts are not reasonably assured until the manufacturer's subsequent sales occur.

Example 2

A media entity enters into a one-year advertising contract with a large retailer for CU120,000 if the advertising campaign reaches certain performance targets. If the advertising campaign does not meet certain performance targets, the consideration is reduced to CU100,000. The entity has significant experience with similar types of contracts and customers. Based on this experience, the entity believes that there is a 90 percent probability of the advertising campaign meeting the performance targets. The entity believes that its experience is predictive of the amount of consideration to which it will be entitled because it has reliable data from past contracts about the likely level of successful and timely completion and has no evidence to suggest that this will change.

The contract has been assessed as a single performance obligation and future services are not distinct. The entity determines that the transaction price is CU120,000 (the fixed contract price of CU120,000 assuming that performance targets are met) which is the most likely amount. If circumstances change, the entity will update its estimate of the transaction price and recognise less revenue using a cumulative catch up approach.

The revised ED proposes that the incremental costs of obtaining a contract with a customer should be recognised as an asset if the entity expects to recover those costs.

Collectibility

The revised ED requires estimates for expected credit losses (i.e., both initial estimates, where required, and subsequent adjustments to those estimates) to be recognised in a separate line item within the statement of comprehensive income adjacent to the gross revenue line item. The proposals do not include a revenue recognition criterion that requires an assessment of the customer's ability to pay the promised amount of consideration.

Media entities may need to assess the implications of any potential change to the presentation of financial results on key performance indicators such as gross margin ratios as the effects of credit risk would be presented within the gross margin.

Contract costs

Costs of fulfilling a contract that are not addressed by another standard would be capitalised if "the costs relate directly to a contract (or a specific anticipated contract), the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future and the costs are expected to be recovered." Examples of such costs might include direct labour and direct materials. However, general and administrative costs and costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract would typically be expensed when incurred. The revised ED also clarifies that the costs that relate directly to a contract include costs that are incurred before the contract is obtained if those costs relate specifically to an anticipated contract (i.e., pre-contract costs).

The revised ED proposes that the incremental costs of obtaining a contract with a customer should be recognised as an asset if the entity expects to recover those costs. Incremental costs are the costs that an entity incurs in its efforts to obtain a contract with a customer and that it would not have incurred if the contract had not been obtained (e.g., a sales commission that becomes payable only if a contract is successfully obtained). Costs that would have been incurred regardless of whether the contract was obtained should be recognised as an expense when incurred, unless they are explicitly chargeable to the customer regardless of whether the contract is obtained. As a practical expedient, acquisition costs incurred may be expensed instead of capitalised for those contracts with an expected duration of one year or less.

Capitalised costs should be amortised "on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates." The period may extend beyond the initial contract term with the customer (e.g., considering contract renewals and related subsequent sales).

The revised ED may alleviate some concerns by some media entities that costs to secure contracts which are significant might have had to be expensed (e.g., acquisition of intellectual property or rights to books, certain deal costs, franchise application fees, subscriber-related costs and pre-publication costs).

Example

A customer signs an 18 month contract with a satellite TV provider entity for a starter bundle consisting of television, broadband internet, and phone. The bundle is offered at CU30 per month (with the cost to the entity of CU10 per month) and is cancelable without penalty at any time. The entity has significant experience with similar types of contracts and customers. Based on this experience, the entity believes that the customers for this type of plan typically stay with the same package for an average of three years. The entity dispatches a technician to a customer's residence to set up and activate the customer's television, broadband internet service and phone service. This process typically takes two hours. The entity incurs set-up costs of CU250 which consist of materials and direct labour. The entity charges new customers a CU120 installation fee to recoup part of the costs incurred. The installed equipment only enables the customer to receive services from this entity. As such, the set-up costs are not considered to be a separate performance obligation.

The entity believes that its experience is predictive of the amount of consideration to which it will be entitled because it has reliable data from past contracts about the likely amount of time that such customers will stay on this particular plan and has no evidence to suggest that this will change. As such, the entity expects to receive total consideration of CU1,200 [(CU30 per month x 36 months) plus CU120 installation fee]. The entity expects the cost of providing the bundle service to be CU360 (CU10 per month x 36 months). As the direct costs incurred enable the entity to satisfy its future performance obligations under the contract and the costs are expected to be recovered, the set-up costs of CU250 would be capitalised and amortised over 36 months (the period that it expects to provide services to the customer, which exceeds the 18 month initial contract term – consistent with the pattern of revenue recognition).

As part of its assessment to identify whether there are separate performance obligations in such contracts, media entities will need to assess whether the upfront fees relate to the transfer of a promised good or service.

Non-refundable upfront fees

Some media entities charge their customers non-refundable upfront fees at or near contract inception. Examples include non-refundable minimum fees in some contracts. As part of its assessment to identify whether there are separate performance obligations in such contracts, media entities will need to assess whether the upfront fees relate to the transfer of a promised good or service. In some circumstances, although the non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not represent the transfer of a promised good or service to the customer. Rather, the upfront fee is an advance payment for future goods or services, and would be recognised as revenue when those future goods or services are provided. The revenue recognition could extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right (i.e., the customer would not need to pay an additional up-front fee upon renewal while other customers would have to pay the additional up-front fee). (Refer to customer incentives section above).

If the non-refundable upfront fee relates to a performance obligation, the fee should be included in the total transaction price and the entity should evaluate whether to account for that performance obligation separately.

Some media entities charge a non-refundable fee in part as compensation for costs incurred in setting up a contract. If those set-up activities do not meet the criteria of a performance obligation, the entity would disregard those activities when measuring progress as set-up costs do not depict the transfer of goods or services to the customer. The entity should evaluate whether such costs incurred in setting up a contract would result in a capitalisable asset (refer to contract costs section above).

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

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