Deloitte.

In This Issue

Navigating ASU 2019-02
Improvements to Accounting for Costs of Films and License Agreements for Program Materials

The Bottom Line

On March 6, 2019, the FASB issued ASU 2019-02,[1] which amends the accounting for production costs for film and episodic television content. Certain key impacts of the ASU's amendments are as follows:

- The constraint on capitalizing episodic television content production costs has been eliminated. Accordingly, the cost capitalization guidance related to episodic content is now aligned with the same guidance for films.
- The subsequent amortization and impairment analysis for a film or license agreement for program material will require entities to determine whether the film or license agreement for program material must be assessed individually or as part of a film group.
- The impairment model for licensed content accounted for in accordance with ASC 920-350[2] has been aligned with the model for produced content in ASC 926-20, which requires impaired assets to be written down to their fair value rather than their net realizable value.
- The ASU amends the presentation and disclosure requirements for both produced and licensed content.

[1] FASB Accounting Standards Update (ASU) No. 2019-02, *Improvements to Accounting for Costs of Films and License Agreements for Program Materials* — a consensus of the FASB Emerging Issues Task Force.

[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

Beyond the Bottom Line

This *Media & Entertainment Spotlight* discusses the implications of the amendments in ASU 2019-02 for film and television production cost accounting and highlights key accounting issues and potential challenges for media and entertainment (M&E) entities that account for film and television production costs under U.S. GAAP.

There have been significant changes within the M&E production and distribution models regarding how media content is produced, acquired, and ultimately monetized. For example, the evolution of direct-to-consumer streaming services has placed less emphasis on any given film or television series and more emphasis on the library of content, which may include both owned (produced) content and licensed content.

Stakeholders had also questioned whether the capitalization guidance for episodic television series under ASC 926-20 was still relevant and provided useful information to investors and other users. Legacy U.S. GAAP provided different requirements for cost capitalization depending on the type of content that an entity produced. Unlike with film production, in which all production costs were capitalized as specified in ASC 926-20, the production costs for an episodic television series could be capitalized only up to the amount of revenue contracted for each episode in the initial market until persuasive evidence existed that revenue from secondary markets would occur or an entity could demonstrate a history of earning such revenue in that market (the "capitalization constraint").

The ASU aligns the accounting for production costs of episodic television series with the accounting for production costs of films by removing the capitalization constraint. The ASU's amendments also address the subsequent amortization and impairment of capitalized film and licensed content costs by requiring entities to first determine how they intend to monetize the film or licensed content (i.e., determine the film group). The ASU defines a film group as:

> The unit of account used for impairment testing for a film or a license agreement for program material when the film or license agreement is expected to be predominantly monetized with other films and/or license agreements instead of being predominantly monetized on its own. A film group represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other films and/or license agreements.

The ASU also amends certain requirements in ASC 920 regarding the accounting for licensed content by broadcasters. Previously, if the programming usefulness of a program was revised downward, a broadcaster would write down unamortized programming costs to their net realizable value. The ASU aligns the impairment model for licensed content with that of owned content, so upon adopting the ASU, entities will need to determine the fair value of their licensed content when recording an impairment.

Connecting the Dots

Although ASU 2019-02 is focused on converging cost capitalization and impairment models between ASC 926 and ASC 920, it also introduces new areas of professional judgment related to asset groupings. The ASU supersedes specific guidance within ASC 926-20, eliminating the cost capitalization constraint on episodic television content and aligning the cost capitalization guidance for both film and television content. The ASU also introduces the concept of identifying film and television assets as a group or individually on the basis of the predominance of monetization. This may lead to a change in how entities determine the identification of content assets, calculate amortization expense, and monitor for impairment considerations.

Summary of Accounting Changes and Impact

We believe that most of the changes in the accounting guidance as a result of ASU 2019-02 will be pervasive across the production and distribution ecosystem in the M&E industry. The changes are expected to affect production companies, studios, broadcasters, and streaming video on demand (SVOD) providers. The convergence of impairment models may have more of an impact on the SVOD providers given the historical content licensing business model.

Key Accounting Issues

Some of the key accounting issues that M&E entities affected by the ASU should consider are discussed below.

- *Removal of cost capitalization constraint for episodic TV content* — The ASU requires entities to capitalize relevant production costs as they are incurred (in the absence of impairment indicators). Legacy U.S. GAAP required capitalized costs to be constrained (1) until there was persuasive evidence of a secondary market and (2) up to the amount of contracted future revenues. The change will allow production costs that were previously expensed to be capitalized.
- *Asset grouping based on predominance of monetization* — Entities will need to use judgment to determine whether their film and other content (e.g., episodic television production assets) are individual assets or group level assets. The ASU states that entities should make this determination by examining how they predominantly monetize their content assets. The monetization strategy may be made individually on a title-by-title basis or at a group level (i.e., together with other film and episodic television content, which may also include licensed content accounted for under ASC 920). This determination is vital since it will affect the level at which capitalized film and other content costs are amortized as well as the establishment of the unit of account when entities are testing these capitalized costs for impairment. Entities should consider the entire life of the assets when determining the predominant monetization strategy of a film or of other content, and the strategy should not be reassessed without a significant change to it, such as "adding a previously unplanned significant distribution channel."

  If the entity concludes that its capitalized film and other content costs (or some subset thereof) are predominantly monetized as a group, it will amortize such costs on a reasonable basis that is reflective of the pattern of usage. For each reporting period, the entity will have to consider whether its estimated use of the asset has changed. Any changes should be reflected prospectively over the remaining estimated life of the asset. In addition, the entity must disclose information regarding the change in estimate.

Connecting the Dots

ASU 2019-02 does not prescribe a method for amortizing film or other content costs in the absence of direct revenues. Accordingly, entities will be required to use judgment to determine a representative pattern of usage.

Example A

Entity 123 internally produces a comedy film with a total production cost of $25,000. Entity 123 intends to predominantly monetize the film by releasing it in theaters worldwide and distributing DVDs, as well as through licensing arrangements with subscription-based content providers and pay/free cable and broadcast networks.

Asset grouping considerations: It may be appropriate for 123 to consider the comedy film as an individual film asset given that 123 intends to predominantly monetize this film asset individually.

Example B

SVOD Provider B is a direct-to-consumer streaming service that has contracted with Entity 123 to create, develop, and produce two seasons of an episodic, scripted comedy series. SVOD Provider B will own the content and account for the production costs under ASC 926. SVOD Provider B has also licensed all nine seasons of an episodic, scripted drama series from Entity XYZ that had previously been in syndication. SVOD Provider B's only source of revenue is subscription revenue that provides customers access to its full library of content and is not attributable to any individual film or episodic series.

Asset grouping considerations: SVOD Provider B most likely intends to monetize the two episodic, scripted drama series as a group rather than individually. Accordingly, B should combine the two series with its other owned and licensed content until it arrives at the lowest level for which identifiable cash flows are largely independent of the cash flows of other films or license agreements.

- *Evaluation for impairment* — Entities are still required under the ASU to test unamortized film and other content costs for impairment "whenever events or changes in circumstances indicate that the fair value of a film . . . or a film group . . . may be less than its unamortized costs." If the entity concludes that it has group level assets, it will be required to test for impairment at the film group level.

The ASU revises the impairment indicators for individual film assets and provides new impairment indicators for film groups. Below are the updated indicators for individual assets and group assets, respectively.

ASC 926-20

35-12A The following are examples of events or changes in circumstances that indicate that an entity shall assess whether the fair value of a film (whether completed or not) is less than its unamortized film costs:

a. An adverse change in the expected performance of a film prior to release
b. Actual costs substantially in excess of budgeted costs
c. Substantial delays in completion or release schedules
d. Changes in release plans, such as a reduction in the initial release pattern
e. Insufficient funding or resources to complete the film and to market it effectively
f. Actual performance subsequent to release failing to meet expectations set before release due to factors such as the following:
    1. A significant adverse change in technological, regulatory, legal, economic, or social factors that could affect the public's perception of a film or the availability of a film for future showings
    2. A significant decrease in the amount of ultimate revenue expected to be recognized.
g. A change in the predominant monetization strategy of a film resulting in the film being predominantly monetized with other films and/or license agreements.

35-12B The following are examples of events or changes in circumstances for a film group that indicate that an entity shall assess whether the fair value of a film group is less than its unamortized film costs:

a. A significant adverse change in technological, regulatory, legal, economic, or social factors that could affect the fair value of the film group
b. A significant decrease in the number of subscribers or forecasted subscribers, or the loss of a major distributor
c. A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection of continuing losses associated with the use or exploitation of a film group.

The ASU also amends the impairment guidance in ASC 920-350 for licensed content so it aligns with the fair value model for owned content. Accordingly, for licensed content that is not part of a film group, the ASU states that if "the programming usefulness of a program, series, package, or daypart are revised downward," any unamortized capitalized costs should be written down to fair value.

Connecting the Dots

For episodic content that is predominantly monetized on its own, the removal of the cost capitalization constraint could increase the risk for impairment. Accordingly, under ASU 2019-02, entities will need to carefully consider their processes and controls for identifying impairment indicators as well as for determining the fair value of the individual asset or asset group. Determining fair value will require new inputs and assumptions in comparison with the historical net realizability model. If impairments are identified, entities will have additional disclosure requirements under the ASU.

- *Removal of the asset classification guidance* — Entities will need to use judgment to determine how to appropriately classify capitalized costs for producing and licensing content on the balance sheet as either current or noncurrent because the ASU eliminates the historical classification guidance within ASC 926-20 and ASC 920-350.

Disclosure Requirements

ASU 2019-02 also amends and supersedes parts of the current disclosure guidance in ASC 926-20-50. Below are the disclosure requirements under the ASU.

ASC 926-20

50-1 Paragraph superseded by Accounting Standards Update No. 2019-02.

50-1A An entity shall disclose its methods of accounting for film costs, including, but not limited to, the following:

a. The method(s) used in computing amortization
b. For impairment, a description of the unit(s) of account used for impairment testing and the method(s) used for determining fair value.

50-2 An entity shall disclose the components of film costs (including released, completed and not released, in production, or in development or preproduction) separately for films predominantly monetized on their own and films predominantly monetized with other films and/or license agreements.

50-3 Paragraph superseded by Accounting Standards Update No. 2019-02.

50-4 Paragraph superseded by Accounting Standards Update No. 2019-02.

50-4A An entity shall disclose the following information in the financial statements or in the notes to financial statements for each period for which a statement of financial performance is presented:

a. The aggregate amortization expense for each period, separately for films predominantly monetized on their own and films predominantly monetized with other films and/or license agreements
b. The caption in the income statement where the amortization is recorded.

50-4B For the most recent annual period for which a statement of financial position is presented, an entity shall disclose the following in the notes to financial statements, separately for films predominantly monetized on their own and for films predominantly monetized with other films and/or license agreements:

a. For completed and not released films, the portion of the costs of completed films that an entity expects to amortize during the upcoming operating cycle. An operating cycle is presumed to be 12 months. An entity shall disclose its operating cycle if it is other than 12 months.
b. For released films, the portion of the costs of released films recognized at the date of the most recent statement of financial position that an entity expects to amortize within each of the next three operating cycles.

50-4C For impairment amounts recognized for films or film groups, an entity shall disclose the following information in the notes to financial statements that include the period in which the impairment is recognized:

a. A general description of the facts and circumstances leading to the impairment
b. The aggregate amount of impairment losses
c. The caption in the income statement where the impairment losses are recorded
d. If applicable, the segment(s) under Topic 280 where the impairment losses are recorded.

Effective Date and Transition

For public business entities (PBEs), the amendments in ASU 2019-02 are effective for fiscal years beginning after December 15, 2019, and interim periods therein. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods therein.

Early adoption is permitted, including early adoption in an interim period, (1) for PBEs for periods for which financial statements have not yet been issued and (2) for all other entities for periods for which financial statements have not yet been made available for issuance.

Transition Considerations

Transition Application

The ASU's amendments require that an entity apply a prospective transition method, meaning the entity must apply the amendments to the capitalization guidance to all film and episodic television content costs that are incurred on or after the beginning of the period that includes the adoption date. The entity must also apply all other amendments at the beginning of the period that includes the adoption date.

When applying the transition guidance, an entity needs to determine the predominant monetization strategy for all its existing film and episodic television content costs for the remaining life of the assets as of the beginning of the interim period that includes the adoption date. That is, the entity must apply a prospective transition method and therefore would not assess the entire life of these assets (i.e., previously amortized costs before the adoption of ASU 2019-02). Instead, the entity will need to consider the predominant monetization strategy in effect at the time of adoption. The FASB's Emerging Issues Task Force (which developed the guidance in the ASU) determined that this method would be appropriate to reduce the costs of implementation. Further, the ASU's amendments require the entity to disclose the nature of and reasons for the change in accounting principle, the transition method, and a qualitative description of the financial statement line items affected by the change.

Increased Use of Judgment

Management will need to exercise significant judgment in applying certain of the ASU's requirements, including those related to the identification of the appropriate asset groups for film and television content assets (i.e., the determination of the predominance of how these assets are monetized), the implementation of new fair value models for licensed content, the monitoring of impairment, and the determination of appropriate asset classification on the balance sheet.

It is important for M&E entities to consider how ASU 2019-02 specifically applies to them so that they can prepare for any changes in film and television cost capitalization and disclosures within the financial statements.

Systems, Processes, and Controls

To comply with the ASU's new accounting and disclosure requirements, M&E entities will have to gather and track information that they may not have previously monitored or that they had accounted for differently before they adopted the ASU. This is because the ASU permits grouping of content assets for subsequent amortization and impairment testing purposes. The systems and processes associated with such information may need to be modified to support the capture of additional data elements that may not currently be supported by legacy systems.

Further, to ensure the effectiveness of internal controls over financial reporting, management may need to assess whether it should implement additional controls, especially regarding (1) the identification of changes in the estimated useful life of content assets and (2) group level content asset considerations, including the initial and subsequent determination of appropriate content asset groupings and the monitoring of content asset groupings for impairment.

Note that the above are only a few examples of changes M&E entities may need to make to their systems, processes, and controls; such entities should evaluate all aspects of the ASU's requirements to determine whether other modifications may be necessary.

Thinking Ahead

Although ASU 2019-02 is not effective until annual reporting periods beginning after December 15, 2019 (with a maximum deferral of one year for nonpublic entities that apply U.S. GAAP), M&E entities should start carefully examining the ASU and assessing the impact it may have on their accounting policies, procedures, systems, and processes.

Dbriefs for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy and tax.
- Controllership perspectives.
- Driving enterprise value.
- Financial reporting.
- Governance, risk, and compliance.
- Innovation in risk and controls.
- Tax accounting and provisions.
- Transactions and business events.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk.

Subscriptions

To subscribe to *Dbriefs*, or to receive accounting publications issued by Deloitte's Accounting Services Department, please register at My.Deloitte.com.

DART and US GAAP Plus

Put a wealth of information at your fingertips. The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosure literature. It contains material from the FASB, EITF, AICPA, PCAOB, and SEC, in addition to Deloitte's own accounting manuals and other interpretive guidance and publications.

Updated every business day, DART has an intuitive design and navigation system that, together with its powerful search and personalization features, enable users to quickly locate information anytime, from any device and any browser. While much of the content on DART is available at no cost, subscribers have access to premium content, such as Deloitte's *FASB Accounting Standards Codification Manual*. For more information, or to sign up for a free 30-day trial of premium DART content, visit dart.deloitte.com.

In addition, be sure to visit US GAAP Plus, our free Web site that features accounting news, information, and publications with a U.S. GAAP focus. It contains articles on FASB activities and those of other U.S. and international standard setters and regulators, such as the PCAOB, AICPA, and SEC. Check it out today!