No. 2016-08
Updated 14 August 2019

Technical Line

FASB — final guidance

How the new revenue standard affects media and entertainment entities

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What you need to know

- Many media and entertainment entities have had to change their accounting for licenses of intellectual property (IP) because, under the standard, entities can only recognize revenue for a license of IP when the customer has a copy of the IP and can use and benefit from it.
- The standard has required media and entertainment entities to exercise more judgment to identify performance obligations, evaluate whether they are acting as a principal or an agent, and measure noncash consideration.
- The standard has significantly changed the timing of revenue recognition for many media and entertainment entities. That's because, under the standard, the timing of revenue recognition depends on the nature of an entity's promise, how contractual restrictions affect the number of performance obligations and whether the contract includes a nonrefundable minimum guarantee.
- This publication has been updated to reflect emerging implementation issues for media and entertainment entities such as the accounting for a sports team's or league's broadcast revenue and the accounting for renewals of licenses of IP. It has also been updated to address the standard's disclosure requirements.

Overview

The new revenue recognition standard[1] issued by the Financial Accounting Standards Board (FASB or Board) requires entities in the media and entertainment (M&E) industry to make additional judgments and estimates such as accounting for licenses of intellectual property (IP), identifying performance obligations, evaluating whether an entity is a principal or an agent, assessing collectibility and measuring noncash consideration.

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This publication highlights key aspects of applying the FASB's standard to an M&E entity's contracts with its customers, addresses significant changes to legacy practice and reflects the latest implementation insights.

As a reminder, the standard is effective for nonpublic entities for fiscal years beginning after 15 December 2018, and interim periods within fiscal years beginning after 15 December 2019. The effective date for public entities was for fiscal years beginning after 15 December 2017, and interim periods in those years.

This publication, which contains a summary of the standard in the appendix, supplements our Financial reporting developments publication (FRD), ***Revenue from contracts with customers (ASC 606)***, and should be read in conjunction with it. The views we express in this publication may continue to evolve as implementation continues and additional issues are identified.

M&E entities should also keep in mind that, when they adopt the new credit impairment standard,[2] they will need to estimate full lifetime expected credit losses for their accounts receivable and contract assets. As a reminder, they will need to do this after assessing collectibility under the revenue guidance to determine whether they have a contract with a customer. Refer to our FRD, ***Credit impairment for short-term receivables under ASC 326***, for more information.

Licenses of IP

Licenses of IP are common in the M&E industry. They include arrangements that grant rights to broadcast live or recorded video content, rights to distribute a film or television program, rights to stream or play music, rights to use a character from a book or film and rights to use a sports team's name and logo.

The standard provides guidance on the accounting for licenses of IP that differs from the guidance for other promised goods and services. To apply the guidance on licenses of IP, M&E entities need to analyze the facts and circumstances of each contract (or type of contract) and apply more judgment than they did under legacy guidance. The accounting outcome also may change.

Determining whether a license is distinct

Contracts for licenses of IP frequently include explicit or implicit promises for additional goods and services. Under the standard, an entity must first determine whether the license and additional goods and services are distinct and, therefore, are separate performance obligations.

For example, a licensor may contract to provide a distribution license for a film and related marketing activities during the license period. The licensor needs to determine whether the license and the related marketing activities are distinct (i.e., whether the customer can benefit from the license and marketing activities on their own or together with readily available resources and whether the license and marketing activities are separately identifiable in the context of the contract). If an entity determines that the license and the related marketing activities are distinct, they would each represent a separate performance obligation to which the transaction price would be allocated.

A license of IP that is not distinct is combined with other goods and services in a single performance obligation. That may be the case if a cable channel provides a customer (e.g., a cable service provider) with a license to its video on-demand library in conjunction with a transmission service and the customer cannot access the videos without the transmission service. The M&E entity then determines the nature of its promise to the customer, considering the standard's guidance on revenue recognition for licenses of IP, to determine whether the overall promise is satisfied over time or at a point in time.

When evaluating licensing arrangements, M&E entities may have to exercise significant judgment to identify performance obligations and determine whether a license of IP is distinct. The facts and circumstances of each arrangement have to be carefully considered.

Determining the nature of the entity's promise in granting a license

Entities are required to classify IP as either functional or symbolic. Functional IP has significant standalone functionality and derives a substantial portion of its "utility" (i.e., the IP's ability to provide benefit or value) from that standalone functionality. A licensor's ongoing activities (e.g., marketing or promotional activities performed by the producer for future TV episodes) generally do not significantly affect the standalone functionality of functional IP. Examples of functional IP include completed media content (e.g., films, television shows or episodes in a television series, music). Revenue from functional IP typically is recognized at a point in time.

Symbolic IP does not have significant standalone functionality because substantially all of the utility is derived from its association with the licensor's ongoing or past support (e.g., activities that support the value of character images licensed from an animated film). Examples of symbolic IP include brands, team and trade names and character images. Revenue from symbolic IP is recognized over time.

Separate usage windows in a license might suggest there are two or more performance obligations in a contract.

IFRS 15, *Revenue from Contracts with Customers*, which the International Accounting Standards Board (IASB) developed jointly with the FASB to largely converge the revenue guidance in IFRS and US GAAP, does not require entities to classify licenses of IP as either functional or symbolic. Instead, entities that apply IFRS 15 must evaluate whether "the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights."

IFRS 15 also specifies that if the IP has significant standalone functionality, the customer will derive a substantial portion of the benefit of that IP from that functionality, and the IP would not be significantly affected by the entity's activities, unless those activities change the form or functionality significantly. The FASB and the IASB agreed that their approaches generally would result in consistent answers, but there could be differences between US GAAP and IFRS when entities license brand names that no longer have any related ongoing activities (e.g., the license to the brand name of a defunct sports team such as the Brooklyn Dodgers).

Contractual restrictions

The standard requires entities to distinguish between contractual provisions that define the attributes of a single promised license of IP (e.g., restrictions of time, geography or use) and other provisions in the contract that require them to transfer additional promised goods or services to the customer (e.g., additional rights to use or access another license of intellectual property). Contractual provisions that are attributes of a promised license define the scope of a customer's rights to IP and do not affect whether a performance obligation is satisfied at a point in time or over time or affect the number of performance obligations in the contract. Significant judgment is required to determine whether a contractual provision results in additional performance obligations (e.g., additional licenses) or defines the scope of the license.

The FASB noted[3] that it evaluated a number of contractual provisions besides those discussed in the standard, including a common contractual provision in the M&E industry called "broken windows." This provision provides for substantial breaks between time periods or windows in a licensing contract during which a customer is able to use (or access) IP. M&E entities had questioned whether the windows in such an arrangement represent separate distinct licenses, even if the rights in each time period are the same. The Board explained that, while it didn't include a broken windows example in the standard, its view is that a substantive break between the time periods for which a customer has the right to use IP might suggest that the customer's rights have been revoked for that period of time and that the entity has made an additional promise to transfer rights to use that same IP again at a later date.

The following table lists examples of common M&E license arrangements with contractual restrictions, along with an analysis of whether the restrictions affect the number of performance obligations identified in the contract.

Example	Does the restriction affect the number of performance obligations identified?
A producer licenses a film to a broadcaster that has the right to air the film once a year for four years.	No. The contract contains one performance obligation. The restriction to only air the film once a year is an attribute of the single promised license because, once the customer controls the rights conveyed by that license, there is no additional promise for the licensor to fulfill.[4] Thus, each airing of the film is not a separate performance obligation.
A distributor licenses a film to a broadcaster for two windows of time (e.g., years one through three and years eight through 10 of the period covered by the contract). The film rights revert to the distributor in years four through seven of the license period, and the rights can be licensed to a different customer during that time.	Maybe. The contract would contain two performance obligations, one for each window of time,[3] if the gap between the two windows of availability (i.e., the period in which the customer's rights are revoked) is substantive. The distributor needs to evaluate whether it has made an additional promise to transfer rights to use the film again in years eight through 10. Judgment likely is required to determine whether a gap between windows is substantive.
A producer licenses a film to a streaming service provider for a five-year period with "staggered rights" (i.e., additional rights that the customer obtains over the contract period). The streaming service provider has rights to the film only in Territory 1 for the first two years of the license period. Starting in year three, it also has rights to the film in Territory 2.	Yes. The contract contains two performance obligations. The producer has granted two distinct licenses because the right to use the film in Territory 1 is distinct from the right to use the film in Territory 2. The producer does not recognize revenue for the performance obligation for the rights in Territory 2 until the streaming service provider is able to use and benefit from those rights. Example 61, Case B,[5] in the standard illustrates a license with staggered rights.

Restrictions on a licensee's ability to use and benefit from a license

Performance obligations that provide a customer with a right to access the entity's IP are satisfied over time because the customer simultaneously receives and consumes the benefit from the entity's performance of providing access and the related activities undertaken by the entity. Entities should select an appropriate method to measure progress toward complete satisfaction of that performance obligation to provide access. Performance obligations that provide a customer with a right to use the entity's IP are satisfied at a point in time. These performance obligations are satisfied when the license transfers to the customer. However, revenue cannot be recognized from a license of IP before (1) a copy of the IP is provided or made available to the customer and (2) the beginning of the period during which the customer is able to use and benefit from its right to access or use the IP.

The requirement to wait to recognize revenue until the beginning of the renewal period is a change from legacy practice.

Street date

In the film, video game, music and publishing industries, contracts often include restrictions on the customer's exploitation of a license (e.g., the date when the customer can distribute the film, typically referred to as the film's street date). M&E entities cannot recognize revenue before the street date if the customer cannot use and benefit from the license before that date.

However, a producer may recognize revenue before the street date when the customer can use and benefit from a license that is not restricted by the street date. Consider the following example: A producer of an animated film to be released on 1 November 20X5 enters into an arrangement with a clothing manufacturer to license the film's character images (i.e., license of symbolic IP) for the production of film-related merchandise. The license period begins on 1 August 20X5, and the licensee can begin using the character images for production and distribution as of that date. The producer would recognize revenue from the license for the character images beginning on 1 August 20X5 (i.e., not 1 November 20X5, the film's street date) because the images are provided to the licensee, and the licensee is able to use and benefit from the license as of that date.

How we see it

This guidance significantly changes legacy practice for film producers that enter into film-related product licenses. They may have to exercise more judgment because the new guidance doesn't address street dates. To determine when to begin recognizing revenue, M&E entities have to evaluate how the restrictions in a license affect the licensee's ability to use and benefit from the license.

Under the legacy film guidance in ASC 926-605, *Entertainment — Films*, *Revenue Recognition,* an entity could not recognize revenue from licenses to film-related products until it released the film.

Approval rights

M&E licensing arrangements may require approval by the licensor for how entities use the IP. For example, a license of a character image may include protective or participative approval rights that give the licensor the right to approve how the character image will be used by the licensee. If the licensor determines that approval rights affect when the customer is able to use and benefit from its right to the IP, the licensor would not recognize revenue until the approval is granted.

Contract modifications and renewals of licenses of IP (updated August 2019)

Update

The FASB has added a project to the agenda of the Emerging Issues Task Force (EITF) to address diversity in practice in (1) accounting for contract modifications that extend a license term but are not solely a renewal of the terms and conditions of the original license and (2) accounting for the revocation of licensing rights. Stakeholders had said that the guidance isn't clear about whether revenue resulting from a modification that is not solely a renewal of the terms and conditions of the original license (e.g., the modification also adds other goods or services or changes the pricing) should be recognized at the date of the modification or at the start of the renewal period.

We encourage readers to monitor developments because any new guidance on this topic could affect accounting for such arrangements. Refer to our To the Point, ***The EITF will address revenue recognition related to contract modifications for licenses of IP***, for further details.

In accordance with the standard, revenue related to the renewal of a license of IP may not be recognized before the beginning of the renewal period because that's when the licensee can use and benefit from the renewed license. For example, consider a producer that on 1 August 20X0 licenses a film to a distributor for a three-year period beginning on 1 January 20X1 and ending on 31 December 20X3. On 30 June 20X3, the license is renewed and extended for an additional three years (i.e., 1 January 20X4 through 31 December 20X6). The producer does not recognize revenue for the renewal license performance obligation before 1 January 20X4 (i.e., the date the second license period begins). Example 59, Case B,[6] in the standard illustrates the accounting for a license renewal.

IFRS 15 does not require an entity to recognize revenue relating to a license renewal at the beginning of the license renewal period. Accordingly, the IASB noted in the Basis for Conclusions on IFRS 15 that entities may recognize revenue for contract renewals or extensions earlier under IFRS than under US GAAP.

How we see it

The requirement to wait to recognize revenue until the beginning of the renewal period is a change from legacy guidance. Under legacy film guidance in ASC 926-605-25-23, producers have recognized license renewals upon the execution of the extension of the renewal (i.e., on 30 June 20X3 in the example above).

M&E entities may need to use judgment to determine the accounting for a contract modification of a license of IP, including a license renewal, especially when the customer already has a copy of the licensed IP. If a change to the contractual terms results in a change in the scope or price (or both) of a contract that is approved by the parties to the contract, it meets the definition of a contract modification.[7] We believe that when a contract that only includes a license of IP is modified, the additional and/or modified license of IP is distinct from the original license because the new and/or modified rights will always differ from those conveyed by the original license. After an entity determines the accounting under the contract modification guidance, entities must evaluate when the customer can use and benefit from the new and/or modified rights to determine when to recognize revenue.

The standard's contract modification guidance requires that a modification in which the additional promised goods or services are distinct be accounted for on a prospective basis, as follows:

- The modification is accounted for as a separate contract if the additional consideration from the modification reflects the new license's standalone selling price in accordance with ASC 606-10-25-12(b). The accounting for the original contract is not affected by the modification, and the revenue recognized to date on the original contract is not adjusted. M&E entities need to evaluate when the customer can use and benefit from the license conveyed in the new contract to determine the appropriate timing for revenue recognition associated with the modified contract.

- The modification is accounted for as a termination of the original contract and the creation of a new contract in accordance with ASC 606-10-25-13(a) if the additional consideration does not reflect the standalone selling price of the new license. Any revenue recognized to date under the original contract is not adjusted. At the modification date, the remaining unrecognized transaction price from the original contract (if any) plus the additional transaction price from the new contract is allocated to the remaining performance obligation(s) in the new contract. Any revenue allocated to a performance obligation created at the modification date for the renewal or extension of a license should not be recognized until the beginning of the renewal or extension period (as described above).

However, the guidance isn't clear on when an entity should account for revenue related to a contract modification of a license of IP that extends a license term and is not solely a renewal of the terms and conditions of the original license (e.g., the modification also adds other goods or services or changes the pricing). As such, M&E entities must evaluate when the customer can use and benefit from a license of IP to determine when to recognize revenue from a contract modification or a contract renewal.

M&E entities may need to use judgment to determine the accounting for a contract modification of a license of IP.

Illustration 1 — Contract modification of a license of IP

Film Studio A is a producer of an episodic television series that it licenses to a broadcaster for a two-year term (1 January 20X7 through 31 December 20X8). As of 1 January 20X7, the episodic television series has been produced and made available for airing to the broadcaster. The license for the series is a license of functional IP that contains a single performance obligation to transfer the licensed IP to the broadcaster for use during the two-year period. Film Studio A allows the broadcaster to air the series a total of six times during the contract term. Film Studio A is not notified when the series is aired, and it isn't notified about how often the series is aired. The price reflects the standalone selling price (SSP) of the license.

On 1 January 20X8, Film Studio A and the broadcaster modify the contract because the broadcaster needs to increase the number of times the broadcaster can air the series. As part of the modification, the old license is terminated, and the broadcaster is granted a new license to air the television series 10 times for a two-year term. This agreement is effective on the date the new agreement is signed (1 January 20X8). The customer receives an 8% discount per airing from the original price because of the added volume.

Film Studio A determines that the additional airings are distinct from the original airings, and the additional airings are not priced at SSP because the price has decreased by 8%. Therefore, the modification is accounted for as a termination of an existing contract and a creation of a new contract.

Under ASC 606, Film Studio A needs to evaluate when the broadcaster can use and benefit from the modified license because that determines when Film Studio A should recognize revenue related to the modified license.

The following are different interpretations that may be acceptable under today's guidance:

Interpretation 1

Film Studio A determines that the modification is (1) the addition of four new airings for a two-year term (1 January 20X8 through 31 December 20X9), (2) a one-year renewal of the original six airings (from 1 January 20X9 through 31 December 20X9) and (3) a reduction of the price of the second year (from 1 January 20X8 through 31 December 20X8) of the original license by 8%.

Film Studio A allocates the additional consideration received upon modification between the four new airings and the renewal of the original six airings. The consideration allocated to the four new airings is recognized on 1 January 20X8, while the consideration related to the renewal of the six airings is deferred and will be recognized on 1 January 20X9, which is the beginning of the license renewal period and the date when the broadcaster is able to use and benefit from the modified license.

Interpretation 2

Film Studio A determines that a new license for 10 airings for a two-year term has been granted. Film Studio A concludes that the broadcaster can use and benefit from the modified license immediately because the customer is not renewing a license with the same terms and conditions as the original contract due to the addition of four new airings in each year and change in pricing. As a result, Film Studio A recognizes the revenue associated with the contract modification on 1 January 20X8.

Sales- or usage-based royalties

M&E entities commonly enter into arrangements that require the customer to pay a sales- or usage-based royalty in exchange for the license of IP. For example, a licensee may be required to pay a percentage of sales of items that use a sports team's name or logo or a fixed amount per number of plays or movie tickets sold.

Sales- or usage-based royalties received in exchange for licenses of IP are recognized at the later of when (1) the subsequent sale or usage occurs or (2) the performance obligation to which some or all of the sales- or usage-based royalty has been allocated is satisfied (in whole or in part). That is, an entity recognizes the royalties as revenue when (or as) the customer's subsequent sales or usage occurs, unless that recognition pattern accelerates revenue recognition ahead of the entity's satisfaction of the performance obligation to which the royalty relates.

It is important to note that this royalty recognition constraint applies only to licenses of IP for which some or all of the consideration is in the form of a sales- or usage-based royalty. Entities cannot analogize to it for other situations. For example, if access to educational software is provided through a license of IP in exchange for a sales-based royalty, the royalty recognition constraint would apply because the royalty relates to a license of IP. In contrast, if a physical book (which may contain the same content as the educational software) is sold in exchange for a share of revenue generated, the royalty recognition constraint would not apply because the sale of the book is not considered a license of IP.

The standard requires that the royalty recognition constraint be applied to the overall royalty stream when the sole or predominant item to which the royalty relates is a license of IP (including when no single license is the predominant item to which the royalty relates, but the royalty predominantly relates to two or more licenses in the contract).

Examples of contracts that may include a license of IP and other goods or services include: (1) a distinct license to access a textbook online and separate tangible study materials that would be provided in the future or (2) a license to distribute a film and a promise by the licensor to provide advertising for the film in the customer's distribution area. For these types of contracts, M&E entities need to assess whether the royalty relates solely or predominantly to the license of IP. If that's the case, the royalty recognition constraint is applied to the overall royalty stream. An entity should not split a single royalty and apply the royalty recognition constraint to a portion of it and the general constraint on variable consideration to the other portion.

M&E entities also need to apply judgment to assess whether the consideration received in exchange for a license of IP is a sales- or usage-based royalty. For example, consider a producer that licenses a film (functional IP) to a subscription-based service provider in exchange for a fixed fee and a per-subscriber fee for subscribers above a specified threshold. The licensor needs to determine how to account for any amounts received for subscribers above the threshold. Specifically, the licensor needs to determine whether the amounts are sales- or usage-based royalties to which the royalty recognition constraint applies. If the per-subscriber fee is determined to be a sales- or usage-based royalty, the royalty recognition constraint will apply, which will result in accounting that is consistent with how producers account for such arrangements under legacy guidance.

Estimating a sales- or usage-based royalty when there is a lag in reporting

M&E entities have questioned whether they can recognize revenue for sales- or usage-based royalties for licenses of IP on a lag if actual sales or usage data is not available at the end of a reporting period. If the conditions in the royalty recognition constraint guidance have been met (i.e., if the underlying sales or usage has occurred and the performance obligation to which the royalties relate has been satisfied or partially satisfied), we believe that licensors without actual sales or usage data from the licensee need to make an estimate of royalties earned in the current reporting period.

The SEC's Chief Accountant noted in a speech[8] that because the FASB did not provide "a lagged reporting exception" in the standard, the reporting of sales- and usage-based royalties may require estimation in some circumstances.

How we see it

Estimating royalties earned in the current reporting period without actual sales or usage data from the licensee may be a significant change in practice for licensors that reported on a lag under legacy practice. Significant judgment might be required for these estimates. Licensors without this data need to implement processes and controls to collect data and develop assumptions to make a reasonable estimate.

The accounting for arrangements with nonrefundable MGs depends on whether the license is of functional IP or symbolic IP.

Nonrefundable minimum guarantees

M&E arrangements commonly include a nonrefundable minimum guarantee (MG) that effectively establishes a floor for the amount of consideration to be paid to the licensor. The MG is referred to in the industry as being "recouped against" sales- or usage-based royalties the licensor would have earned. The licensor earns additional sales- or usage-based royalties when the royalties exceed the nonrefundable MG. MGs may be negotiated for several reasons and may take different forms. For example, a contract might establish a minimum amount of consideration that is payable to the licensor in installments over the term of the license period or the minimum amount of consideration could be paid at the beginning or end of the license period.

Contracts with an MG and a sales- or usage-based royalty include both fixed and variable consideration. How a licensor recognizes an MG as revenue will depend on whether the license is for functional IP or symbolic IP.

Licenses of functional IP

FASB-only members of the Joint Transition Resource Group for Revenue Recognition (TRG),[9] which the FASB and IASB formed to help to address implementation issues, generally agreed[10] that an MG recouped against sales- or usage-based royalties in a license of functional IP should be recognized as revenue at the point in time that the entity transfers control of the license to the customer, like other revenue for this type of IP license. Any royalties above the fixed minimum would be recognized in accordance with the royalty recognition constraint.

If there is only one performance obligation in the contract, M&E entities may not need to change their accounting. Consider a contract with a customer where a producer's only performance obligation is to license a film (functional IP) in exchange for a nonrefundable MG that is recouped against sales-based royalties, and the producer earns additional sales-based royalties when they exceed the nonrefundable MG. Under both legacy guidance and the standard, the nonrefundable MG would be recognized at the beginning of the license period, and any amounts earned above the nonrefundable MG through the sales-based royalty would be recognized as the subsequent sale or usage occurs.

However, in other contracts, M&E entities may have multiple performance obligations to which the nonrefundable MG and royalties that exceed the nonrefundable MG must be allocated. This is common in cross-collateralized film arrangements under which an M&E entity may license several films in exchange for (1) a nonrefundable MG that is recouped against sales-based royalties for all of the films and (2) additional sales-based royalties when they exceed the nonrefundable MG.

For contracts containing more than one performance obligation (e.g., if each film is a separate performance obligation), the entity would allocate the estimated transaction price, including the nonrefundable MG and additional royalties, to the performance obligations. While the standard includes guidance for allocating the transaction price to performance obligations, the application of that guidance to cross-collateralized films requires judgment. Refer to Step 4 of the appendix.

How we see it

This is a change for M&E entities. Under legacy film guidance in ASC 926-605-25-20, the transaction price was not allocated to the individual films since it could not be objectively determined. The requirement in ASC 606 to allocate the transaction price to each of the performance obligations requires judgment and may result in a change in when revenue is recognized.

Licenses of symbolic IP

FASB TRG members generally agreed[10] that various recognition approaches could be acceptable for nonrefundable MGs in licenses of symbolic IP, which require revenue to be recognized over time. The TRG agenda paper described two approaches. Under one, an M&E entity would estimate the total consideration (i.e., the fixed minimum and the variable consideration from future royalties) and apply an appropriate measure of progress to recognize revenue as the M&E entity satisfies the performance obligation, subject to the royalty recognition constraint. Alternatively, an M&E entity could apply a measure of progress to the fixed consideration and begin recognizing the variable component when the fixed amount is exceeded on a cumulative basis. An entity should disclose the accounting policy it selects because this would likely affect the timing of revenue recognized.

The first approach can be applied in two different ways, as follows:

> *View A*: If an entity expects cumulative royalties to exceed the MG, the entity may determine that an output-based measure is an appropriate measure of progress and apply the right to invoice practical expedient because the royalties due for each period correlate directly with the value to the customer of the entity's performance each period. Because it applies the practical expedient for recognizing revenue, the entity would not need to estimate the expected royalties beyond determining whether it expects the royalties to exceed the MG at contract inception.
>
> The right to invoice practical expedient allows an entity to recognize revenue in the amount for which it has the right to invoice if the entity has a right to payment from a customer in an amount that corresponds directly with the value of the entity's performance completed to date.
>
> *View B*: An entity estimates the transaction price for the performance obligation (including fixed and variable consideration) and recognizes revenue using an appropriate measure of progress, subject to the royalty recognition constraint. If an entity does not expect cumulative royalties to exceed the MG, the measure of progress is applied to the MG because the transaction price will at least equal the fixed amount.

The second approach can be summarized as follows:

> *View C*: An entity recognizes the MG (fixed consideration) using an appropriate measure of progress and recognizes royalties only when cumulative royalties exceed the MG.

The FASB staff noted in the TRG agenda paper that in order for an entity to apply View C, the symbolic license would have to be considered a series of distinct goods or services (i.e., a series of distinct time periods), and the variable consideration (i.e., the royalties in excess of the minimum guarantee) would have to be allocated to the distinct time periods to which they relate.

To illustrate the application of these views, consider the following example from TRG agenda paper no. 58:

Illustration 2 — Accounting for a license of symbolic IP in exchange for an MG and sales-based royalty

A producer of an animated film enters into a five-year arrangement with a clothing manufacturer to license the film's character images (symbolic IP) for the production of film-related merchandise. The license requires the clothing manufacturer to pay a sales-based royalty of 5% of its gross sales; however, the contract includes a guarantee that the producer will receive a minimum of $5 million for the entire five-year period.

The clothing manufacturer's actual gross sales and the related royalties each year are as follows (this information is not known at the beginning of the contract):

Year 1 — $15 million (royalties equal $750,000)

Year 2 — $30 million (royalties equal $1.5 million)

Year 3 — $40 million (royalties equal $2 million)

Year 4 — $20 million (royalties equal $1 million)

Year 5 — $60 million (royalties equal $3 million)

Total royalties equal $8.25 million.

View A: The producer expects total royalties to exceed the MG. The producer determines that an output-based measure is an appropriate measure of progress and applies the right to invoice practical expedient because the royalties due for each period correlate directly with the value to the customer of the producer's performance each period. The producer recognizes revenue from the sales-based royalty when the customer's subsequent sales occur.

(in 000s)	Year 1	Year 2	Year 3	Year 4	Year 5
Royalties received	750	1,500	2,000	1,000	3,000
Annual revenue	750	1,500	2,000	1,000	3,000
Cumulative revenue	750	2,250	4,250	5,250	8,250

View B: The producer estimates the transaction price (including fixed and variable consideration) for the contract. The producer determines that time elapsed is an appropriate measure of progress and recognizes revenue ratably over the five-year term of the contract, subject to the royalty recognition constraint (i.e., cumulative revenue recognized cannot exceed the cumulative royalties received once the MG has been met).

(in 000s)	Year 1	Year 2	Year 3	Year 4	Year 5
Royalties received	750	1,500	2,000	1,000	3,000
Royalties (cumulative)	750	2,250	4,250	5,250	8,250
Fixed + variable (ratable)*	1,650	1,650	1,650	1,650	1,650
Annual revenue	1,650	1,650	1,650	300	3,000
Cumulative revenue	1,650	3,300	4,950	5,250	8,250

* Assuming the producer's estimated transaction price (fixed and variable consideration) is $8.25 million, the annual revenue that could be recognized is $1.65 million ($8.25 million divided by five years (contract term)).

In Year 4, the cumulative revenue using a time-elapsed measure of progress of $6.6 million ($4.95 million plus $1.65 million) exceeds the cumulative royalties received ($5.25 million). As such, the total cumulative revenue recognized through Year 4 is constrained to the total cumulative royalties received, or $5.25 million.

View C: The producer recognizes the MG (fixed consideration) using an appropriate measure of progress and recognizes royalties only when cumulative royalties exceed the MG. The producer determines that time elapsed is an appropriate measure of progress.

The producer applies the royalty recognition constraint to the sales-based royalties in excess of the MG (i.e., recognizes the royalties as revenue when the MG is exceeded on a cumulative basis). The variable consideration (royalties in excess of the MG) is allocated to the distinct periods using the variable consideration allocation exception.

(in 000s)	Year 1	Year 2	Year 3	Year 4	Year 5
Royalties received	750	1,500	2,000	1,000	3,000
Royalties (cumulative)	750	2,250	4,250	5,250	8,250
Fixed (ratable)**	1,000	1,000	1,000	1,000	1,000
Annual revenue	1,000	1,000	1,000	1,250	4,000
Cumulative revenue	1,000	2,000	3,000	4,250	8,250

** Because the MG is $5 million over the contract term, the annual revenue (excluding royalties in excess of the MG) is $1 million ($5 million divided by five years (contract term)).

In Year 4, the cumulative royalties received ($5.25 million) exceed the total MG ($5 million) by $250,000. As such, the annual revenue recognized in Year 4 is $1.25 million ($1 million annual revenue, plus $250,000 of royalties in excess of the MG).

In Year 5, the annual revenue recognized ($4 million) is calculated as the $1 million annual revenue plus the royalties for that year ($3 million) since the royalties exceeded the MG in Year 4.

The standard does not prescribe a single approach that must be applied in all circumstances in which a sales-based or usage-based royalty is promised in exchange for a license of IP and the contract includes a minimum guaranteed amount. An M&E entity should consider the nature of its arrangements and make sure that the measure of progress that it selects does not override the core principle of the standard that "an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."

How we see it

The timing of revenue recognition for many arrangements that include nonrefundable MGs may change due to the guidance on licenses of functional and symbolic IP and the requirement to allocate consideration to each of the performance obligations in a cross-collateralized licensing arrangement (i.e., an arrangement involving rights to multiple films, territories or markets in accordance with the definition of cross-collateralized under ASC 926). Entities need to exercise judgment to allocate the transaction price for cross-collateralized licensing arrangements to each of the performance obligations in the contract.

License of content library

An M&E entity may enter into a licensing arrangement for an existing content library and unspecified changes that will be made to the content library in the future (e.g., a license for a film producer's completed titles and any titles produced in the future, a license for an existing music library and any songs added or removed in the future). Typically, the contractual license fee is not adjusted if the licensor does not obtain or create new content to provide to the licensee over the term of the contract.

Accounting for a license of a content library as multiple performance obligations may be a change in practice for some entities.

In these arrangements, the licensor needs to evaluate the promised goods or services in the contract to determine the number of performance obligations (e.g., whether the license for the existing content library is distinct from other promises in the contract, including the license for the future content library). That is, entities must consider whether the individual good or service is capable of being distinct and whether the promise to transfer the good or service is distinct in the context of the contract.

The license for the existing content library is considered distinct from the other promised goods or services in the contract if it is separately identifiable from them. That might not be the case if the licensor provides a significant integration service, the promised goods or services significantly modify or customize each other, or the existing content license is highly interdependent or interrelated with the other promised goods or services.

If the entity determines that there is more than one performance obligation (e.g., one for the license to the content library provided at the inception of the arrangement, and the second for the obligation to provide updates to the content library, when and if available), the licensor will need to allocate the transaction price to the separate performance obligations on a relative standalone selling price basis.[11]

How we see it

Accounting for a license of a content library as more than one performance obligation may be a change in practice for some entities. Under legacy guidance, music entities typically identified one deliverable for providing access to a library of music that was updated throughout the license period and recognized the license fee ratably over the license period.

Under the new standard, film entities may identify a deliverable for the content library provided at the inception of the arrangement, estimate the number of future deliverables to be provided during the license period and allocate revenue proportionately. Further, estimating the standalone selling price for the performance obligation(s)[11] requires significant judgment and may significantly affect the pattern of revenue recognition.

Affiliate fees

An M&E entity may enter into an agreement with an affiliate to provide a continuous feed of its broadcast programming in exchange for a monthly fee per affiliate subscriber or a combination of an annual fixed fee and monthly fee per affiliate subscriber. An M&E entity needs to evaluate the nature of its promise to determine whether it is granting the affiliate a license of IP (i.e., its media content) or providing an overall transmission service to the affiliate (i.e., the media content is an input into the combined output of the transmission service). In making this determination, an M&E entity should consider whether the affiliate obtains control of the media content (i.e., the ability to direct the use of and obtain substantially all of the benefit from the media content).

In some affiliate agreements, the broadcast programming is transmitted to the affiliate and placed on its servers so that the affiliate can configure the content into the required format for transmission to its customers. The affiliate agreement may also allow the affiliate to use the content on its servers to enable "playback" features, network DVR functionality or video on-demand capabilities.

The M&E entity needs to evaluate the promised goods or services in the contract to determine the number of performance obligations (e.g., whether the other services or video on-demand capabilities are distinct from the broadcast programming). If the M&E entity determines that it has a single performance obligation, it might conclude that the nature of its promise to the affiliate is to provide a license of IP because the affiliate obtains control of the IP and can use it in various ways permitted by the license (i.e., the affiliate agreement). In this scenario, the M&E entity's transmission of the content to the affiliate is a fulfillment activity that it must perform to deliver the licensed content.

An M&E entity that determines that the affiliate obtains control of the media content and, therefore, the nature of its promise is to provide a license of IP applies the sales- or usage-based royalty recognition constraint if the monthly fee per subscriber is a sales- or usage-based royalty. That is, the M&E entity recognizes the fee per subscriber as revenue when the underlying usage occurs (e.g., monthly based on the subscribers for that month). Any fixed fee is recognized at the point in time that the license transfers to the customer, provided that both of the following conditions have been met:

- An entity provides (or otherwise makes available) a copy of the intellectual property to the customer
- The period during which the customer is able to use and benefit from its right to access or its right to use the intellectual property has begun

Since the M&E entity provides additional IP each day over the contract term, it recognizes the fixed fee as it delivers content to the affiliate because that is when the affiliate is able to use and benefit from the additional daily broadcast programming.[12]

A different analysis is required if the affiliate simply rebroadcasts the transmission from the M&E entity to its customers but does not obtain a right to use or access the underlying IP. In this case, the M&E entity may conclude that the affiliate does not obtain control of the media content, and the M&E entity is providing a service that includes IP as an input to the combined output of the overall transmission service. If the IP is not the predominant item to which the royalty relates, the M&E entity would not apply the royalty recognition constraint. Instead, the M&E entity would need to determine the amount and timing of revenue to recognize as the entity satisfies its performance obligation to provide the transmission service.

Broadcast revenues (added August 2019)

Sports teams and leagues often enter into arrangements with local or national broadcasters to provide the broadcaster (customer) with the right to televise the team's or league's live games, among other promises (e.g., rights to use the team's or league's trade name, rights to digitally distribute the games, rights to provide video-on-demand access). When accounting for these arrangements under the standard, entities first determine the promise(s) in the contract and the nature of these promises (e.g., whether the right to televise the team's or league's live games is a license of IP or a service) and then determine whether the promises should be separate performance obligations or whether some may be combined into one performance obligation. Entities then consider the nature of the performance obligation(s) to determine whether the underlying promise(s) is (are) satisfied over time or at a point in time and to select an appropriate measure of progress for performance obligations satisfied over time.

The remainder of this discussion focuses on the accounting for the right to televise the team's or league's live games, which is typically the predominant promise in the contract and might be accounted for as a license of functional IP or as a service, depending on the terms of the contract.

License of functional IP

Some contracts may provide the rights to transmit the copyrighted content of the games to the broadcaster, in which case the entity would likely conclude that the nature of the promise represents a license of IP. If the contract conveys a license of IP, entities *must* follow the licenses guidance.

M&E entities will need to use judgment to determine the nature of their promise in a sports broadcast contract.

M&E entities must evaluate the promised goods or services in the contract to determine the number of performance obligations and evaluate when the customer can use and benefit from the license of IP to determine when to recognize revenue. M&E entities may conclude that each game represents a separate license of functional IP that the customer can use and benefit from when each game is delivered. If the entity concludes that each game represents a separate performance obligation, M&E entities would allocate the transaction price to each game based on a relative standalone selling price, unless an allocation exception applies, and recognize revenue from each game when the customer can begin to use and benefit from the IP. If the consideration in the contract is variable, M&E entities should consider whether the criteria are met to apply the variable consideration allocation exception,[13] which requires entities to allocate the variable consideration in the contract to one or more, but not all, performance obligations in the contract.

In addition, entities should evaluate whether the standalone selling price of games within a season and across seasons varies when allocating the transaction price (e.g., playoff games may have a higher standalone selling price than regular season games). In these circumstances, M&E entities would recognize revenue at escalating rates if the rates reflect the standalone selling price of each distinct license (e.g., rights to each game). As mentioned above, M&E entities also need to consider other promises in the contract and how they affect the allocation of the transaction price and recognition of revenue.

Service

If the M&E entity does not provide a license of IP to the broadcaster, it may conclude that the nature of the promise is to provide a service to the broadcaster. In such circumstances, M&E entities consider whether the series guidance[14] applies. If the criteria to apply the series guidance are met, entities are required to treat the series as a single performance obligation.

M&E entities allocate the transaction price to each performance obligation in the contract and recognize revenue as each performance obligation is satisfied. M&E entities should consider whether the criteria are met to apply the variable consideration allocation exception,[13] which requires entities to allocate the variable consideration in the contract to one or more, but not all, performance obligations in the contract. If the criteria to apply the variable consideration allocation exception are not met, entities are required to recognize revenue in an amount that reflects performance over time. As mentioned above, M&E entities also need to consider other promises in the contract and how they affect the allocation of the transaction price and recognition of revenue.

Other industry considerations

Participation costs

M&E entities need to consider the amount and timing of revenue recognized under the standard when determining the participation costs[15] accrual. Under ASC 926, participation costs are estimated and accrued based on the ratio of current-period actual revenue to an estimate of the remaining unrecognized ultimate revenues (i.e., all revenue expected to be received from the exploitation, exhibition and sale of a film in all markets and territories, including theatrical, home video, television, digital services and DVD/Blu-ray). Participation costs are generally required to be paid by producers as royalties are collected.

However, ASC 926 requires that, as of each reporting date, accrued participation costs should not be less than the amounts that a producer is obligated to pay based on royalties collected and revenue recognized as of that date. Thus, changes in amounts allocated to individual performance obligations or changes in the timing of revenue recognition may affect the timing of when participation costs are accrued. For example, participation costs accrued may be affected by (1) the allocation of an MG to individual films that are cross-collateralized or (2) changes to the timing of recognition of an MG and sales-based royalty related to symbolic IP.

How we see it

Applying the new standard may result in changes in the timing of revenue recognition that may affect when participation costs are accrued.

Free goods and services

M&E entities frequently offer free products and services as an inducement for customers to enter into contracts (e.g., free advertisements that are bundled with paid advertisements, a free tablet with a subscription, free tickets for the sponsor of a sports team). Although an entity might not consider those goods or services to be the main items the customer receives under the contract, the FASB concluded that the customer pays for these goods or services, and the entity should therefore evaluate whether they are separate performance obligations. If they are separate performance obligations, the entity allocates a portion of the transaction price to those free goods or services and recognizes that revenue when those free goods or services are transferred to the customer.

The standard allows entities to disregard promises that are determined to be immaterial in the context of the contract. That is, an M&E entity that determines certain customer inducements are immaterial in the context of the contract is allowed to disregard them in its revenue accounting and is not required to aggregate and assess them for materiality at the entity level. However, M&E entities are required to accrue for the costs of goods or services determined to be immaterial in the context of the contract when revenue from the contract is recognized.

Shipping and handling

The standard allows M&E entities to elect to account for shipping and handling activities (e.g., for DVDs, books, CDs) performed after control of a good has been transferred to the customer as a fulfillment cost (i.e., not a promised good or service). If an M&E entity elects this policy, it is required to accrue for shipping and handling activities as fulfillment costs. That is, entities are required to accrue for the costs of shipping and handling activities if revenue is recognized before contractually agreed shipping and handling activities occur.

M&E entities that have free onboard shipping point arrangements might instead determine that the act of shipping is a performance obligation under the standard. If that were the case, the M&E entity would allocate a portion of the transaction price to the shipping service and recognize it when (or as) the shipping occurs.

Shipping and handling activities performed before the transfer of control of a good are fulfillment activities rather than promised services because they relate to the entity's asset and not the customer's asset, and the costs are incurred to facilitate the sale of the good to the customer.

If an entity considers shipping and handling activities to be a promised service to the customer, we believe the related costs should be classified as cost of sales because the costs would be incurred to fulfill a revenue obligation. We believe entities need to apply judgment to determine how to classify shipping and handling costs when the related activities are not considered a promised service to the customer (e.g., when an entity uses the accounting policy election to account for shipping and handling as a fulfillment activity). This is because the standard does not address how entities should classify these costs.

Principal versus agent considerations

When more than one party is involved in providing goods or services to an M&E entity's customer, the M&E entity must determine whether its performance obligation is to provide the good or service itself (i.e., the M&E entity is a principal) or to arrange for another party to provide the good or service (i.e., the M&E entity is an agent).

An entity is a principal and therefore records revenue on a gross basis if it controls a promised good or service before transferring that good or service to the customer. To apply the principal versus agent guidance, an entity must first properly identify the specified good or service (or unit of accounting for the principal versus agent evaluation) to be transferred to the customer. A specified good or service is defined as each distinct good or service or distinct bundle of goods or services promised to the customer.

Entities involved in co-production, co-distribution and advertising arrangements and digital providers that distribute content may need to assess whether they are acting as a principal or an agent. Significant judgment may be required to make this assessment. M&E entities may also consider the indicators that an entity is a principal (see Step 2 in the appendix) to support its assessment about whether it controls the good or service before the good or service is transferred to the customer.

Variable consideration and the constraint

The standard requires entities to estimate variable consideration when some or all of the transaction price varies (e.g., due to discounts, rebates, refunds, credits, incentives, bonuses or penalties, contingencies, price concessions). An entity estimates variable consideration using either an "expected value" or "most likely amount" method, as described in the standard. Refer to Step 3 of the appendix. To include variable consideration in the estimated transaction price, the entity has to conclude that it is "probable" that a significant revenue reversal will not occur in future periods. This requirement, known as the constraint on

variable consideration, is aimed at preventing the over-recognition of revenue. As discussed above, a recognition constraint applies to sales- and usage-based royalties received in exchange for a license of IP that differs from the constraint on variable consideration.

Illustration 3 — Estimating the transaction price in an advertising arrangement

Advertising Agency A enters into a six-month advertising campaign agreement ($500,000 fixed fee) that also includes a potential $100,000 performance bonus linked to certain goals. The agency estimates it is 90% likely to receive the entire performance bonus and 10% likely to receive none of the bonus.

Because of the binary nature of the outcome (the agency will either receive the performance bonus or not receive it), Advertising Agency A determines that the most likely amount method is the better predictor of the amount to which it expects to be entitled. The agency has significant experience with these types of arrangements and with estimating whether it will achieve the goals and receive the performance bonus. The uncertainty will be resolved in a short timeframe (i.e., at the end of the six-month campaign). Thus, the agency determines that it is probable that a significant reversal will not occur and includes the $100,000 performance bonus in the transaction price. The total transaction price of $600,000 would be recognized over the six-month advertising campaign period. As a result, the agency would recognize revenue earlier than under legacy guidance, which required the goals to be met and the performance bonus to be achieved before the $100,000 performance bonus could be recognized.

Exchange of advertising

Advertising exchanged for content

In certain licensing arrangements between producers and networks, a producer will provide a license of IP to a network in exchange for cash and/or the right to sell advertising spots on the network. A producer needs to determine the nature of the rights received from the network to sell the advertising spots. For example, the producer needs to determine whether the rights to the advertising spots represent a contingent payment based on the network's use of the licensed IP, an asset (i.e., noncash consideration) that the producer obtains control of as consideration for the licensed IP or something else.

If the producer believes the rights to the advertising spots represent a contingent payment, the producer may determine that it is appropriate to account for the monetization of the advertising spots as a usage-based royalty if the ad spots are inextricably linked to the value of the licensed IP.

The producer records revenue for any fixed cash consideration when control of the license of IP is transferred to the network. Any consideration from the sale of advertising spots is subject to the usage-based royalty recognition constraint and is recognized as revenue when the usage of the licensed content occurs (i.e., when the advertisements are aired).

If the producer determines that it receives an asset from the network, it will account for the advertising time as noncash consideration received from the network. The producer's subsequent sale of the advertising spots to other customers is separate from the contract to license IP to the network because the producer controls the advertising spots. Therefore, the producer records revenue for the fair value of the advertising spots (measured at contract inception) when the licensed content is provided to the network. The producer also recognizes revenue (and a corresponding cost of sales for the recorded value of the advertising spots) when the advertising spots are aired by the network.

An entity needs to carefully analyze contracts involving the license of IP in exchange for advertising spots to determine the appropriate accounting.

How we see it

Accounting for the right to sell advertising spots as a contingent payment subject to the usage-based royalty constraint results in a pattern of revenue recognition that is similar to the pattern under legacy guidance. However, revenue is recognized earlier than under legacy guidance if a producer receives an asset from the customer (in the form of advertising spots) that is accounted for as noncash consideration.

Under legacy guidance, producers recognized revenue from licensing content both when the license period began for any cash received and when the producer used the advertising time received or sold it to a third party. The legacy guidance on advertising barter arrangements has been superseded by the revenue standard.

Advertising exchanged for advertising (updated August 2019)

M&E entities need to use more judgment when analyzing the facts and circumstances of advertising barter transactions (e.g., internet advertising exchanged for television advertising). An entity needs to first determine whether the arrangement meets the criteria to be considered a contract with a customer, including whether the contract has commercial substance (i.e., the contract is expected to change the risk, timing or amount of the entity's future cash flows). If the entity determines the arrangement is a contract with a customer, it includes the fair value of the advertising received, measured at contract inception, in the transaction price for the advertising sold.

Accounting for advertising received, instead of the advertising surrendered, at its fair value is a change from legacy guidance.

How we see it

Recognizing revenue for the fair value of the advertising received is a change from legacy guidance, which required revenue to be recognized at the fair value of the advertising surrendered.

Under ASC 606, if the fair value of the advertising received is not determinable, the advertising barter transaction is recorded based on the standalone selling price of the advertising surrendered.

If the risk, timing or amount of an entity's future cash flows from the advertising received are not expected to significantly change when compared with the risk, timing or amount of future cash flows from the advertising surrendered, the transaction may not have commercial substance and would not be accounted for as a contract with a customer.

Rights of return

An entity may provide its customers with a right to return goods. Under the standard, the potential for customer returns should be considered when an entity estimates the transaction price because potential returns cause consideration to be variable. This applies to M&E entities that sell physical goods to retailers, such as DVDs, CDs and books. When sales of the goods occur, an entity records a right of return asset for its right to recover the goods expected to be returned by the customer and a refund liability for the obligation to return the customer's consideration based on the entity's estimate of potential returns.

How we see it

While the recognition and measurement for rights of return under the standard has not significantly changed from practice under legacy GAAP, there are some notable differences related to presentation. Changes from legacy practice include: (1) presenting a right of return asset separate from inventory and testing it for impairment and (2) presenting the refund liability separately from the right of return asset. M&E entities also have to assess whether their models for estimating returns under legacy guidance are appropriate, given the need to use an expected value or most likely amount estimation method and to consider the constraint.

Free trial periods with a subscription

Free trial periods are common in certain M&E arrangements involving subscriptions to magazines, newspapers, cable and streaming services. A customer may receive a number of "free" months of goods or service at the inception of an arrangement, before the paid subscription begins, or as a bonus period at the beginning or end of a paid subscription period.

In accordance with the standard, revenue is not recognized until an entity determines that a contract with a customer exists. Once an entity determines that a contract exists, it is required to identify the promises in the contract. Therefore, if the entity has transferred goods/services prior to the existence of a contract, the free goods or services provided during the trial period would generally be accounted for as marketing incentives.

For example, an entity has a marketing program to provide free trials of a magazine to prospective customers. The entity's customers are not required to pay for the magazines provided during the free trial period, and the entity is under no obligation to provide the magazines under the marketing program. If a customer enters into a contract with the entity, which obligates the entity to provide magazines in the future (e.g., 12 magazines over the next annual period) and obligates the customer to pay for the magazines, the magazines provided as part of the marketing program may not be promises enforceable in the contract with the customer.

However, if an entity, as part of a negotiation with a prospective customer, agrees to provide three free magazines if the customer agrees to pay for 12 magazines (effectively providing the customer a discount on 15 magazines), the entity would identify the free magazines as promises in the contract because the contract requires it to provide them.

The above interpretation applies if the customer is not required to pay consideration for the additional goods or services during the trial period (i.e., they are free). If the customer is required to pay consideration in exchange for the goods or services received during the trial period (even if it is only a nominal amount), a different accounting conclusion could be reached. Entities need to apply judgment to evaluate whether a contract exists that falls within the scope of the standard.

Multiyear agreements with changing prices (updated August 2019)

It is common for M&E entities to have multiyear, fixed-price agreements with annual increases or decreases in the rates for the same goods or services provided over the contract term. Examples include advertising/promotion campaigns, content right agreements, sponsorship arrangements between a sports team or league and a sponsor and other service arrangements. These contracts often have one or more performance obligations that are satisfied over time and meet the requirement to be accounted for as a series of distinct goods or services because at least some of the promises are substantially the same and have the same pattern of transfer to the customer over time. M&E entities have questioned whether they can recognize revenue based on the changing rates in the contract or whether they need to recognize revenue ratably over the contract duration because their performance is the same each year.

When accounting for these arrangements under the standard, entities first determine the promise(s) in the contract and the nature of these promises (e.g., a service or a license of IP) and then determine whether any promises should be combined into one performance obligation. An entity may be able to recognize revenue based on the contractual rates in these types of contracts if it determines that each year in the contract represents a separate performance obligation (and those performance obligations are priced at standalone selling price) or the performance obligation meets the criteria to apply the standard's right to invoice practical expedient. In order for an M&E entity to conclude that each year represents a separate performance obligation, the entity would need to conclude that the nature of its promise is not substantially the same each year (and therefore, does not meet the criteria to apply the series guidance), which may require significant judgment. For example, an entity might conclude that the rights promised in the contract are different each year (e.g., different events are held that reach new viewers each year and different activities are undertaken by the entity that provide different value to the customer, and, therefore the entity's performance is not substantially the same each year).

The standard's right to invoice practical expedient allows an entity to recognize revenue in the amount for which it has the right to invoice if the entity has a right to payment from a customer in an amount that corresponds directly with the value of the entity's performance completed to date (e.g., an advertising arrangement in which an agency bills a fixed amount for each hour of service provided). TRG members discussed[16] the right to invoice practical expedient and generally agreed that entities have to exercise judgment about when they can apply it. They also generally agreed that it is possible for entities to meet the requirements for the practical expedient in contracts with changing rates.

In determining whether the amount invoiced to the customer corresponds directly with the value to the customer of an M&E entity's performance completed to date, the M&E entity could evaluate how the amount invoiced compares with market prices, standalone selling prices or another reasonable measure of value to the customer (e.g., changes in viewership, affiliate revenues, advertising rates). That is, a contract does not need to have a fixed price per unit for the duration of a contract for an entity to apply the practical expedient. M&E entities need to have evidence that the changes in the contract pricing directly correlate with the changes in the value to the customer, which may be difficult to determine depending on the nature of the services and pricing structure in the contract.

TRG members discussed[16] examples of contracts with increasing (or decreasing) fees/rates that reflect value provided to the customer that may have characteristics that are similar to those of M&E arrangements with changing prices. These included an information technology outsourcing arrangement with rates that decrease over the contract term as the entity's level of effort to provide the service to the customer decreased or a multiyear electricity contract that contemplates the forward market price of electricity. The value to the customer may be corroborated through benchmarking (market) adjustments (e.g., most favored nation clauses that benchmark the rates) and/or changing costs that reflect the level of effort to provide the service that corresponds with the change in price of the activities.

However, the Securities and Exchange Commission Observer noted at the TRG meeting that entities need to have strong evidence that variable prices represent the value to the customer in order to recognize variable amounts of revenue for similar goods or services. M&E entities should analyze the facts and circumstances of each arrangement and be aware that they may reach different conclusions than they did under legacy GAAP.

If an entity cannot conclude that each year in the contract is a separate performance obligation (because each year is substantially same) or the performance obligation does not meet the criteria to apply the right to invoice practical expedient, the entity needs to determine a measure of progress to reflect the satisfaction of its performance obligations, which may be ratably throughout the contract.

Contract costs

Costs to obtain a contract

Under ASC 340-40,[17] incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) are recognized as an asset if the entity expects to recover them. TRG members generally agreed[18] that commissions paid to all employees, regardless of how directly involved the employees were in obtaining a contract, would be considered incremental costs if they wouldn't have been incurred if the contract had not been obtained. Sales commissions paid to employees solely as a result of obtaining a customer contract may require capitalization if an entity does not apply the practical expedient described in the appendix. This may result in a change in practice for M&E entities that have historically expensed these costs as incurred.

In contrast, some incentive payments such as bonuses and other compensation that are based on other quantitative or qualitative metrics not related to contracts obtained (e.g., profitability, earnings per share, performance evaluations) likely do not meet the criteria for capitalization because they are not incremental costs of obtaining a contract.

Costs to fulfill a contract

Entities should continue to follow the guidance on costs incurred in fulfilling a contract with a customer that are in the scope of other ASC topics. They include ASC 920-350[19] on costs of program materials for broadcasters, ASC 922-350[20] on programming and other system costs during the prematurity period and successful franchise application costs, ASC 922-360[21] on initial subscriber installation costs, ASC 926-20[22] on film or episodic television series production costs and ASC 928-340[23] on artist compensation costs and record master costs.

If no specific guidance is provided in another ASC topic, the standard requires an entity to recognize an asset from the costs incurred to fulfill a contract only if those costs meet certain criteria (see *Contract costs* in the appendix). The standard also states that costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (i.e., costs that relate to past performance) are expensed as incurred.

Direct-response advertising

M&E entities may use direct-response advertising to generate sales from a customer (e.g., magazine advertisements that include order coupons for an entity's products, direct-response television ads). Legacy guidance in ASC 340-20[24] allowed entities to accrue the costs of direct-response advertising if certain criteria were met. This guidance has been superseded.

M&E entities are still required to accrue the costs of advertising when they are incurred subsequent to recognizing revenue (e.g., in cooperative advertising arrangements).

Customer options for additional goods or services

M&E contracts often include options for the customer to acquire additional goods or services. Entities need to determine whether these options represent material rights and, if so, account for them as separate performance obligations.

Determining whether an option provides a material right to the customer requires significant judgment. When making this determination, an entity should first evaluate whether the option is independent of the existing contract. For example, an M&E entity offers a coupon for a discount on the digital version of a textbook with the purchase of the physical textbook. Because the coupon is not provided to customers who do not buy the physical textbook (i.e., customers that do not have an existing contract with the M&E entity), it may be a material right.

Another common example in the M&E industry is an option, included in a license agreement for season one of a television show, for a television network to acquire additional seasons (or the right of first refusal for additional seasons) of the show at fixed prices for each season. The licensee's decision to exercise the option for additional seasons likely depends on the success of the series in the previous season, and therefore, the price of each additional season may escalate. An M&E entity needs to determine whether the price for the additional seasons indicates there is a material right for the additional seasons. If the price of each additional season is determined to represent its standalone selling price at contract inception, the option is not considered a material right.

Nonrefundable up-front fees

M&E entities in the cable industry often charge nonrefundable activation or installation fees at contract inception. These fees are generally not associated with performance obligations. In a month-to-month cable contract, the customer's ability to renew each subsequent month without having to pay the activation or installation fee may represent a material right, which gives rise to a separate performance obligation. An M&E entity allocates a portion of the transaction price to the material right (which may differ from the activation or installation fee charged to the customer) and recognizes that amount over the period of benefit of the activation or installation fee, which may be the estimated customer life in some situations.

A cable customer's ability to renew each month without having to pay the activation or installation fee may represent a material right.

In a longer, fixed-term contract, the activation or installation fee may be insignificant compared with the total transaction price. In these cases, it is less likely that an M&E entity will determine there is a material right related to the renewal option. Regardless of whether there is a material right in the contract, the activation or installation fee is included in the total transaction price that is allocated to the performance obligations in the contract.

Measurement of options that are separate performance obligations

An M&E entity that determines that an option is a separate performance obligation needs to determine the standalone selling price of the option. In most cases, the M&E entity does not sell the option on a standalone basis and, therefore, needs to estimate the standalone selling price. This may require significant judgment.

The standard also provides an alternative to estimating the standalone selling price of an option. This practical alternative applies when the goods or services are both (1) similar to the original goods and services in the contract and (2) provided in accordance with the terms of the original contract (typically those types of options are for contract renewals).

Under this alternative, a portion of the transaction price is allocated to the option (i.e., the material right that is a performance obligation) by reference to the total goods or services expected to be provided to the customer (including expected renewals) and the corresponding expected consideration. That is, the total amount of consideration expected to be received from the customer (including from expected renewals) is allocated to the total goods or services expected to be provided to the customer, including the expected contract renewals. The amount allocated to the goods or services that the entity is required to transfer to the customer under the contract (i.e., excluding the optional goods or services that will be transferred if the customer exercises the renewal option(s)) is then subtracted from the total amount of consideration received (or that will be received) for transferring those goods or services. The difference is the amount that is allocated to the option at contract inception.

Illustration 4 — Estimating the standalone selling price of options that are separate performance obligations
Publisher A sells a physical textbook for $10 and offers the customer an option to purchase the digital version of the publication for 50% off the retail price of $8. The typical discount for digital versions is 15%. Therefore, Publisher A concludes that this discount exceeds the typical discount offered to customers and that it provides the customer with a material right. To estimate the standalone selling price of the option, Publisher A estimates there is a 50% likelihood that a customer will redeem the discount option. Therefore, Publisher A's estimated standalone selling price of the discount option is $1.40 ($8 digital price x 35% incremental discount x 50% likelihood of exercising the option). Publisher A allocates $1.23 {$10 x [$1.40 / ($1.40 + $10)]} of the transaction price to the discount option and recognizes revenue for the option when the customer exercises its right for the digital version or when the option expires. Publisher A allocates $8.77 ($10 − $1.23) to the physical book and recognizes revenue for the physical book when it transfers control of the book to the customer.

Disclosure requirements (updated August 2019)

The standard significantly increases the number of disclosure requirements. Public entities are required to disclose quantitative and qualitative information about contracts with customers (including disaggregated revenues and performance obligations), as well as significant judgments made in applying the standard, among other things. Nonpublic entities can choose to provide the same or streamlined disclosures.

Some of the disclosure requirements that may affect M&E entities are described in the following sections.

Performance obligations

To help users of financial statements analyze the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, an entity is required to disclose information about its performance obligations. Qualitative and quantitative disclosures include information about the nature of the entity's promise (e.g., a service or a license of IP), significant payment terms (e.g., sales- or usage-based royalties, contracts with nonrefundable minimum guarantees) and when the entity typically satisfies its performance obligations (e.g., point in time or over time).

In some cases, determining the nature of the performance obligation may require judgment. For example, in affiliate agreements, M&E entities must determine whether the nature of their promise is to provide a license of IP or an overall transmission service to the affiliate. M&E entities should provide qualitative disclosure regarding the nature of their performance obligations with respect to the key revenue streams, especially in instances where judgment is required to determine the nature of the performance obligations.

Significant judgments

The standard requires disclosure of significant judgments and changes in judgments made in applying the standard that significantly affect the amount and timing of revenue recognition. In particular, entities are required to disclose judgments and changes in judgments made in determining the transaction price, amounts allocated to performance obligations and the timing of satisfaction of performance obligations. For M&E entities, this may include information

about estimating the standalone selling price of promised goods or services, estimating variable consideration, including applying the constraint, determining whether a customer option gives rise to a material right and allocating discounts to a specific part of a contract.

In addition, M&E entities need to consider whether they made significant judgments in evaluating whether they are the principal or agent in various transactions. For example, if they make significant judgments in determining whether they are a principal or an agent in theatrical/home video distribution arrangements, advertising arrangements and/or ticketing arrangements, M&E entities should provide robust disclosures explaining the judgments applied and conclusions reached.

Disclosure of remaining performance obligations

A public entity is required to disclose information about remaining performance obligations, including the amount of the transaction price allocated to performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period and when it expects to recognize the amount(s) in its interim and annual financial statements. The FASB provided optional exemptions that allow an entity not to make quantitative disclosures about remaining performance obligations in certain situations, including when an estimate of the transaction price would be made solely for disclosure purposes, as well as for contracts with an original expected duration of less than one year.

These situations include: (1) when an entity applies the right to invoice practical expedient in ASC 606-10-55-18, (2) when variable consideration in the contract is due to a sales- or usage-based royalty promised in exchange for a license of intellectual property accounted for under ASC 606-10-55-65 through 65B and (3) when variable consideration is allocated entirely to a wholly unsatisfied performance obligation or to a wholly unsatisfied promise to transfer a distinct good or service that forms part of a single performance obligation (i.e., a series of distinct goods or services) when certain criteria are met.

These optional exemptions only apply to the portion of the transaction price that is variable consideration and meets the conditions of the exemptions. If a contract includes both fixed consideration and variable consideration and the variable consideration meets one of the conditions for applying the exemptions, an entity will still be required to disclose the remaining fixed consideration. For example, a guaranteed minimum amount of consideration included in a sales- or usage-based royalty is fixed consideration, and the remaining amount to be recognized under the minimum should be disclosed.

Entities that elect to use any of the standard's optional exemptions allowing them not to disclose the aggregate transaction price allocated to the remaining performance obligations must disclose which optional exemption(s) they are applying, the nature of the performance obligations, the remaining duration of the contract and a description of the variable consideration that has been excluded from the disclosure (e.g., the nature of the variability and how that variability will be resolved).

Disclosure of revenue related to satisfied performance obligations

The standard requires entities to disclose the amount of revenue recognized in the period that relates to amounts allocated to performance obligations that were satisfied (or partially satisfied) in previous periods (e.g., due to a change in transaction price or in estimates related to the constraint on revenue recognized).

How we see it

Disclosing the revenue recognized from performance obligations satisfied in previous periods is a change in practice for M&E entities. This type of revenue includes sales- or usage-based royalties an M&E entity receives in a reporting period after it delivers functional IP. M&E entities need to make sure they have appropriate systems, policies and procedures and internal controls in place to collect and disclose the required information.

Endnotes:

[1] Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, as amended, was created by Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, and various amendments.

[2] ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.

[3] Paragraph BC45 of ASU 2016-10, *Identifying Performance Obligations and Licensing*.

[4] Paragraph BC44 of ASU 2016-10.

[5] ASC 606-10-55-399K through 55-399O.

[6] ASC 606-10-55-392A through 55-392D.

[7] ASC 606-10-25-12 through 25-13.

[8] Speech by Wesley R. Bricker, 9 June 2016. Refer to SEC website at https://www.sec.gov/news/speech/bricker-remarks-35th-financial-reporting-institute-conference.html.

[9] The FASB and the IASB created the TRG to help them determine whether more guidance is needed on their new revenue standards (ASC 606 and the IASB's standard IFRS 15, *Revenue from Contracts with Customers*) and to educate constituents. While the group met jointly in 2014 and 2015, only FASB TRG members participated in the meetings in 2016.

[10] 7 November 2016 TRG meeting; agenda paper no. 58.

[11] Licenses of content library arrangements typically are provided in exchange for fixed consideration and/or variable consideration in the form of a sales- or usage-based royalty. This section assumes the transaction price does not include any other form of variable consideration that could be subject to the variable consideration allocation exception in ASC 606-10-32-39.

[12] ASC 606-10-55-58C.

[13] ASC 606-10-32-39.

[14] ASC 606-10-25-14(b) and ASC 606-10-25-15.

[15] Participation costs are accrued by film producers and include contingent payments based on the financial results of a film pursuant to contractual formulas (participations) and by contingent amounts due under provisions of collective bargaining agreements (residuals). Such parties are collectively referred to as participants, and such costs are collectively referred to as participation costs. Participations may be given to creative talent, such as actors or writers, or to entities from whom distribution rights are licensed.

[16] 13 July 2015 TRG meeting; agenda paper no. 40.

[17] ASC 340-40, *Other Assets and Deferred Costs — Contracts with Customers,* was created by ASU 2014-09.

[18] 7 November 2016 TRG meeting; agenda paper no. 57.

[19] ASC 920-350, *Entertainment — Broadcasters — Intangibles — Goodwill and Other.*

[20] ASC 922-350, *Entertainment — Cable Television — Intangibles — Goodwill and Other.*

[21] ASC 922-360, *Entertainment — Cable Television — Property, Plant, and Equipment.*

[22] ASC 926-20, *Entertainment — Films — Other Assets — Film Costs.*

[23] ASC 928-340, *Entertainment — Music — Other Assets and Deferred Costs.*

[24] ASC 340-20, *Other Assets and Deferred Costs — Capitalized Advertising Costs.*

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SCORE No. 00838-171US
(Updated 14 August 2019)

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Appendix: The five-step revenue model and contract costs

The standard's core principle is that an entity will recognize revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer. That principle will be applied using five steps that require entities to exercise judgment when considering the terms of their contract(s) and all relevant facts and circumstances. Entities will have to apply the requirements of the standard consistently to contracts with similar characteristics and in similar circumstances. This table summarizes the new revenue model and the guidance for contract costs.

Step 1: Identify the contract(s) with the customer

Definition of a contract

An entity must first identify the contract, or contracts, to provide goods and services to customers. A contract must create enforceable rights and obligations to fall within the scope of the model in the standard. Such contracts may be written, oral or implied by an entity's customary business practices but must meet the following criteria:

- The parties to the contract have approved the contract (in writing, orally or based on their customary business practices) and are committed to perform their respective obligations
- The entity can identify each party's rights regarding the goods or services to be transferred
- The entity can identify the payment terms for the goods or services to be transferred
- The contract has commercial substance (i.e., the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract)
- It is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer

If these criteria are not met, an entity would not account for the arrangement using the model in the standard and would recognize any nonrefundable consideration received as revenue only when certain events have occurred.

Contract combination

The standard requires entities to combine contracts entered into at or near the same time with the same customer (or related parties of the customer) if they meet any of the following criteria:

- The contracts are negotiated as a package with a single commercial objective
- The amount of consideration to be paid in one contract depends on the price or performance of another contract
- The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation

Contract modifications

A contract modification is a change in the scope and/or price of a contract. A contract modification is accounted for as a new contract separate from the original contract if the modification adds distinct goods or services at a price that reflects the standalone selling prices of those goods or services. Contract modifications that are not accounted for as separate contracts are considered changes to the original contract and are accounted for as follows:

- If the goods and services to be transferred after the contract modification are distinct from the goods or services transferred on or before the contract modification, the entity should account for the modification as if it were the termination of the old contract and the creation of a new contract
- If the goods and services to be transferred after the contract modification are not distinct from the goods and services already provided and, therefore, form part of a single performance obligation that is partially satisfied at the date of modification, the entity should account for the contract modification as if it were part of the original contract
- A combination of the two approaches above: a modification of the existing contract for the partially satisfied performance obligations and the creation of a new contract for the distinct goods and services

Step 2: Identify the performance obligation(s) in the contract

An entity must identify the promised goods and services within the contract and determine which of those goods and services (or bundles of goods and services) are separate performance obligations (i.e., the unit of accounting for purposes of applying the standard). An entity is not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract.

A promised good or service represents a performance obligation if (1) the good or service is distinct (by itself or as part of a bundle of goods or services) or (2) the good or service is part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer.

A good or service (or bundle of goods or services) is distinct if both of the following criteria are met:

- The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e., the good or service is capable of being distinct)
- The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e., the promise to transfer the good or service is distinct within the context of the contract)

In assessing whether an entity's promise to transfer a good or service is separately identifiable from other promises in the contract, entities need to consider whether the nature of the promise is to transfer each of those goods or services individually or to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate two or more promises to transfer goods or services are not separately identifiable include, but are not limited to, the following:

- The entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted
- One or more of the goods or services significantly modify or customize, or are significantly modified or customized by, one or more of the other goods or services promised in the contract
- The goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract
- If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct

Series guidance

Goods or services that are part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer must be combined into one performance obligation. To meet the same pattern of transfer criterion, each distinct good or service in the series must represent a performance obligation that would be satisfied over time and would have the same measure of progress toward satisfaction of the performance obligation (both discussed in Step 5), if accounted for separately.

Customer options for additional goods or services

A customer's option to acquire additional goods or services (e.g., an option for free or discounted goods or services) is accounted for as a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).

Principal versus agent considerations

When more than one party is involved in providing goods or services to a customer, an entity must determine whether it is a principal or an agent in these transactions by evaluating the nature of its promise to the customer. An entity is a principal and, therefore, records revenue on a gross basis if it controls the specified good or service before transferring that good or service to the customer. An entity is an agent and records as revenue the net amount it retains for its agency services if its

role is to arrange for another entity to provide the specified goods or services. Because it is not always clear whether an entity controls a specified good or service in some contracts (e.g., those involving intangible goods and/or services), the standard also provides indicators of when an entity may control the specified good or service as follows:

- The entity is primarily responsible for fulfilling the promise to provide the specified good or service
- The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (e.g., if the customer has a right of return)
- The entity has discretion in establishing the price for the specified good or service

Step 3: Determine the transaction price

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. When determining the transaction price, entities will need to consider the effects of all of the following:

Variable consideration

An entity will need to estimate any variable consideration (e.g., amounts that vary due to discounts, rebates, refunds, price concessions, bonuses) using either the expected value method (i.e., a probability-weighted amount method) or the most likely amount method (i.e., a method to choose the single most likely amount in a range of possible amounts). An entity's method selection is not a "free choice" and must be based on which method better predicts the amount of consideration to which the entity will be entitled. To include variable consideration in the estimated transaction price, the entity has to conclude that it is probable that a significant revenue reversal will not occur in future periods. This "constraint" on variable consideration is based on the probability of a reversal of an amount that is significant relative to cumulative revenue recognized for the contract. The standard provides factors that increase the likelihood or magnitude of a revenue reversal, including the following: the amount of consideration is highly susceptible to factors outside the entity's influence, the entity's experience with similar types of contracts is limited or that experience has limited predictive value, or the contract has a large number and broad range of possible outcomes. The standard requires an entity to estimate variable consideration, including the application of the constraint, at contract inception and update that estimate at each reporting date.

Significant financing component

An entity will need to adjust the transaction price for the effects of the time value of money if the timing of payments agreed to by the parties to the contract provides the customer or the entity with a significant financing benefit. As a practical expedient, an entity can elect not to adjust the transaction price for the effects of a significant financing component if the entity expects at contract inception that the period between payment and performance will be one year or less.

Noncash consideration

When an entity receives, or expects to receive, noncash consideration (e.g., property, plant or equipment, a financial instrument), the fair value of the noncash consideration at contract inception is included in the transaction price.

Consideration paid or payable to the customer

Consideration payable to the customer includes cash amounts that an entity pays, or expects to pay, to the customer, credits or other items (vouchers or coupons) that can be applied against amounts owed to the entity or equity instruments granted in conjunction with selling goods or services. An entity should account for consideration paid or payable to the customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service. However, if the payment to the customer exceeds the fair value of the distinct good or service received, the entity should account for the excess amount as a reduction of the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract
For contracts that have multiple performance obligations, the standard generally requires an entity to allocate the transaction price to the performance obligations in proportion to their standalone selling prices (i.e., on a relative standalone selling price basis). When allocating on a relative standalone selling price basis, any discount within the contract generally is allocated proportionately to all of the performance obligations in the contract. However, there are two exceptions. One exception requires variable consideration to be allocated entirely to a specific part of a contract, such as one or more (but not all) performance obligations or one or more (but not all) distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation, if both of the following criteria are met: ‣ The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service ‣ Allocating the variable consideration entirely to the performance obligation or the distinct good or service is consistent with the objective of allocating consideration in an amount that depicts the consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer The other exception requires an entity to allocate a contract's entire discount to only those goods or services to which it relates if certain criteria are met. To allocate the transaction price on a relative standalone selling price basis, an entity must first determine the standalone selling price of the distinct good or service underlying each performance obligation. The standalone selling price is the price at which an entity would sell a good or service on a standalone (or separate) basis at contract inception. Under the model, the observable price of a good or service sold separately in similar circumstances to similar customers provides the best evidence of standalone selling price. However, in many situations, standalone selling prices will not be readily observable. In those cases, the entity must estimate the standalone selling price by considering all information that is reasonably available to it, maximizing the use of observable inputs and applying estimation methods consistently in similar circumstances. The standard states that suitable estimation methods include, but are not limited to, an adjusted market assessment approach, an expected cost plus a margin approach or a residual approach (if certain conditions are met).
Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation
An entity recognizes revenue only when (or as) it satisfies a performance obligation by transferring control of the promised good(s) or service(s) to a customer. The transfer of control can occur over time or at a point in time. A performance obligation is satisfied at a point in time unless it meets one of the following criteria, in which case it is satisfied over time: ‣ The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs ‣ The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced ‣ The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date The transaction price allocated to performance obligations satisfied at a point in time will be recognized as revenue when control of the goods or services transfers to the customer. If the performance obligation is satisfied over time, the transaction price allocated to that performance obligation will be recognized as revenue as the performance obligation is satisfied. To do this, the standard requires an entity to select a single revenue recognition method (i.e., measure of progress) that faithfully depicts the pattern of the transfer of control over time (i.e., an input method or an output method).

Licenses of intellectual property

The standard provides guidance on the recognition of revenue for licenses of IP that differs from the model for other promised goods and services. The nature of the promise in granting a license of IP to a customer is either:

- A right to access the entity's IP throughout the license period (a right to access)
- A right to use the entity's IP as it exists at the point in time in which the license is granted (a right to use)

To determine whether the entity's promise is to provide a right to access its IP or a right to use its IP, the entity should consider the nature of the IP to which the customer will have rights. The standard requires entities to classify IP in one of two categories:

- Functional: This IP has significant standalone functionality (e.g., many types of software, completed media content such as films, television shows and music). Licenses of functional IP generally grant a right to use the entity's IP and revenue for these licenses generally will be recognized at the point in time when the IP is made available for the customer's use and benefit. This will be the case if the functionality is not expected to change substantially as a result of the licensor's ongoing activities that do not transfer an additional promised good or service to the customer. If the functionality of the IP is expected to substantively change because of activities of the licensor that do not transfer additional promised goods or services, and the customer is contractually or practically required to use the latest version of the IP, revenue for the license will be recognized over time. However, we expect licenses of functional IP to meet the criteria to be recognized over time infrequently, if at all.
- Symbolic: This IP does not have significant standalone functionality (e.g., brands, team and trade names, character images). The utility (i.e., the ability to provide benefit or value) of symbolic IP is largely derived from the licensor's ongoing or past activities (e.g., activities that support the value of character images). Licenses of symbolic IP grant a right to access an entity's IP and revenue from these licenses will be recognized over time as the performance obligation is satisfied (e.g., over the license period).

Revenue cannot be recognized from a license of IP before both (1) an entity provides (or otherwise makes available) a copy of the IP to the customer and (2) the beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the IP.

The standard specifies that sales and usage-based royalties on licenses of IP will be recognized when the later of the following events occurs: (1) the subsequent sales or usage occurs or (2) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied). This guidance must be applied to the overall royalty stream when the sole or predominant item to which the royalty relates is a license of IP (i.e., these types of arrangements will be either entirely in the scope of this guidance or entirely in the scope of the general variable consideration constraint guidance).

Contract costs

ASC 340-40 specifies the accounting for costs an entity incurs to obtain and fulfill a contract to provide goods and services to customers. The incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) will be recognized as an asset if the entity expects to recover them. ASC 340-40 cites commissions as a type of incremental cost that may require capitalization. The standard provides a practical expedient that permits an entity to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less.

An entity accounts for costs incurred to fulfill a contract with a customer that are within the scope of other authoritative guidance (e.g., inventory, property, plant and equipment, internal-use software) in accordance with that guidance. If the costs are not in the scope of other accounting guidance, an entity will recognize an asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:

- The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify
- The costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future
- The costs are expected to be recovered

Any capitalized contract costs are amortized, with the expense recognized as an entity transfers the related goods or services to the customer. Any asset recorded by the entity is subject to an impairment assessment.