Media & Entertainment Industry

Key Accounting Matters

19 December 2015

Agenda

- The M&E Landscape

- Overview of key segments
  - Television
  - Print
  - Films
  - Animation & VFX
  - Digital advertising
  - Others

- Key Accounting matters
  - Revenue Recognition
  - IP Creation / Acquisition
  - Others

The Landscape

Media

TV

Broadcasting
- Over The Top (OTT)

Distribution
- Direct To Home (DTH)
- Multi Source Operator (MSO)
- Local Cable Operator (LCO)

Print

Newspaper
Magazines (periodicals)
Professional/Educational books

Radio

Outdoor (OOH)

Digital advertising

Entertainment

Films

Production
Distribution
Exhibition

Music

Animation & VFX

Live Entertainment

Gaming

The Growth Story

(Figures in INR 00’s crores)

Sector	Segment	Industry Size 2014	Estimated CAGR (2014-2019)	Industry Size in 2019	Major players
Media	TV	474.9	15.5%	975.5	Star, Sony, Zee network
	Print	263.4	8.0%	386.8	BCCL, Hindustan times, Dainik Bhaskar
	Radio	17.2	18.1%	39.5	Radio mirchi, Radio city, Red FM, Radio One
	OOH	22.0	9.8%	35.1	OOH media, Percept OOH
	Digital advertising	43.5	30.2%	162.5	WPP group, Madhouse, Publicis
Entertainment	Films	126.4	10.0%	204.0	YashRaj , Dharma , UTV , Eros
	Music	9.8	14.0%	18.9	Saregama, Universal music, T-Series Ltd.
	Animation & VFX	44.9	16.3%	95.5	Disney, Reliance media works, Cartoon network
	Gaming	23.5	14.3%	45.8	Sony computer entertainment, Disney India
	Total	**1,026**	**13.9%**	**1,964**	

- *CAGR for the period 2009 – 2014 is 11.8 % , where the fastest growing segment was digital advertising (40%)*

Source: FICCI Report 2015

Growing Scope of Media

- Media convergence is the coming together of computing, telecommunication and media in a digital environment.
- Today 80% of the internet users own a smart phone where they have access to content by means of data connection on their phones provided by telecoms.
- Distribution via downloadable applications, which allow consumers to access news content, magazine content and games and this is a growth area for M&E companies
- Today advertisement revenue on digital platform is the main source of income for technology giants like Facebook and Google.

Key Matters – Media and Entertainment

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Revenue recognition Topics

Gross v/s Net reporting of revenue

How should revenues be disclosed in the below cases – whether on a gross or net basis ?

- **Advertising agencies** – Cost incurred and revenue earned from customers plus commission revenue. The advertising agency deals with the media on behalf of the advertiser. Further, volume discounts are given as a percentage of total value of advertisements placed by the advertising agency.
- **Film exhibitor** – Collections from ticket sales as revenue while collection is shared with distributor.
- **Media house** – Commission given to advertising agencies while billed to customer.

Applicable guidance – AS 9 Revenue recognition

Guidance under Indian GAAP is judgmental and not clearly rule based:

- As per AS 9 - Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from rendering of services.
- Further, AS 9 states that in an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.
- However what constitutes an agency relationship is not clearly defined under the accounting standards.

Gross v/s Net reporting of revenue

Other source of guidance for understanding agency relationship:

- Ind AS 115 (IFRS 15 has similar guidance) , the indicators that an entity is an agent are : -
  - Another party is primarily responsible for fulfilling the contract
  - Entity does not have inventory risk
  - Entity does not have discretion in establishing prices
  - Consideration is in the form of a commission
  - Not exposed to credit risk

- US GAAP (ASC 605) would further fine this guidance with more indicators to evaluate:

Gross, if entity is :

- Primary obligor
- Latitude in establishing price
- Credit risk
- Bears the risk of inventory
- Determining the service specification
- Discretion in selection of media/ supplier

Net, if entity is :

- Not the primary obligor
- Earnings are fixed
- No credit risk

Barter Transactions

How should we account for barter transactions ?

A barter arrangement is a scenario wherein two parties enter into a transaction to exchange similar or dissimilar goods or services. Part consideration could also be settled in cash.

- **Media House** - Broadcasters exchange rights to place advertisement on each others channels.
- **Publisher** - Publishers / Internet Companies exchange space on each others media / websites.
- **Media House** - Advertising revenue earned in exchange of real estate or equity shares.

Applicable guidance – Guidance note on accounting by Dot com companies, AS 10 Accounting for fixed assets and AS 13 Accounting for Investments.

No specific guidance under Accounting Standards for barter transactions:

- As per AS 13, when an investment is acquired in exchange for an asset/ services, the cost of the investment is determined by reference to the fair value of the asset/ services given up.
- Fair value of the investment acquired in exchange is considered if it is more clearly evident.
- Similar accounting treatment suggested under AS 10 when an asset is acquired.

Barter Transactions

Other source of guidance for understanding barter revenue accounting:

- Guidance Note on accounting for Dot-com companies :
  - Recorded only if there is a commercial substance to the transaction.
  - Generally, no revenue from barter transactions involving exchange of similar goods or services is recognised.
  - Recorded based on the fair values of assets or services involved.
  - Sale transactions between similar unrelated buyers in the preceding 6 months should be considered for determining the fair value

- As per Ind AS 18 barter revenue can be recognised only when the exchange of advertising services are dissimilar and the amount of the revenue can be reliably measured.

- Seller can reliably measure revenue at the fair value of the advertising services by reference only to non-barter transactions that involve similar services.

- For the evaluation of similar / dissimilar use there is no specific guidance in the India literature.

Multiple Element Contracts

Amounts to be allocated to each element of a multiple element contract ?

- **DTH** - Sale of box, activation fee, installation fee as part of a bundled contract. (currently mixed practises are followed in relation to revenue deferral).
- **Media House** - Providing airtime across programmes, time bands or channels, including properties, bonus / free spots.
- **Film producers** - Assignment of multiple rights like theatrical and non theatrical i.e. music, pay TV and other rights.
- **Media House** - Providing bonus / free spots bundled with normal paid spots for TV ratings.

Applicable guidance – No specific guidance under Indian GAAP

- Many Indian M&E companies account for each deliverable within the overall arrangement based on the form of documentation in the contract and based on the stated prices.
- Many times the prices stated in the contract are based on tax considerations.
- No separate evaluation of multiple elements existing in a single legal contract is performed.
- Similarly, a separate fair value for each element within the contract is not determined if separate prices are stated in the contract for each deliverable.

Multiple Element Contracts

Other source of guidance for understanding barter revenue accounting:

- Under Ind AS 18, it may be necessary to segment a single contract into its components (elements), with different revenue allocations for each component.
- Generally, if separate elements have a stand-alone value to a customer, the allocation of overall revenues to individual elements would be required irrespective of whether all elements are documented in a single contract or in separate concurrent contracts.
- Application of Ind AS 18 may result in a deferral of revenue in several cases, where upfront recognition is currently followed.
  - For example, activation fees which may currently be recognised as revenue on the date of installation, may need to be deferred and recognised over a customer relationship period.
- Separate methods are recommended under Ind AS 115 for allocation of transaction prices
- Under US GAAP, an element should be identified separately if -
  - Each element has value to the customer on a stand-alone basis
  - There is objective and reliable evidence of the fair value of the undelivered item
  - The amount of revenue allocable to a delivered item is capped at the non contingent amount.
  - Revenue to be recognised on delivery and not based on billing.

Film Rentals and Licensing

When should revenue be recognised by a film producer in case of licensing of rights for theatrical release or for telecast release?

Applicable guidance – AS 9 Revenue Recognition

- No specific guidance under AS 9, however the principles of AS 9 can be used for determining revenue.

Licensing of rights for theatrical release

- Producers license film rights for theatrical release in a particular for a limited period.
- Per the industry norms the following types of revenue are generated by Film producers

Type of Revenue	Recognition
Minimum Guarantee received upfront	Entire amount recognised on release of the film.
Revenue Share	Recognised based on the theatrical revenues earned during the period based on the information received from the exhibitor

Film Rentals and Licensing

Licensing of rights to a Broadcaster

- Producers also assign the copyrights to broadcasters or home video companies for a period commencing in the future.
- Example - Satellite rights with a restriction on telecast for 3 months from theatrical release.
- Revenue should be deferred till the time rights become active since the licensor retains effective control by way of precluding the licensee to exploit the right.
- Since the broadcaster's ability to use commences only on the telecast commencement date, the control and the attached risks are deemed to pass only after the effective date.
- Even in case of a further sub-lease, though money is realised by the broadcaster, it is for the contract period commencing on the first telecast date.
- However, many companies in India do not defer revenue by arguing that the delivery of the tapes is completed and payment has been received. Further, they believe that the restriction on telecast is only protective in nature.

Intellectual Properties

Accounting for Intellectual Property (IP) - Identification

Measurement, amortisation and valuation of an IP ?

- Intellectual Property could be a film, a television programme, a live event (For example, a sports event) or a music album.
- IPs are either acquired or internally generated by broadcasters and TV software producers.

Applicable guidance – AS 26 Intangible assets and AS 28 Impairment of assets

- AS 26 allows intangible to be recognized if
  - It is controlled by enterprise as a result of past events
  - Future economic benefits from the asset will flow to the Company
  - Cost of asset can be measured
- For internally generated IPs, AS 26 requires the process of producing the IP to be segregated into research and development phase. Cost incurred in research phase are expensed as incurred.
- Criteria to be evaluated for recognition of an intangible asset:
  - Technical feasibility
  - Intention to complete
  - Ability to use or sell
  - Existence of a market
  - Availability of resources

Accounting for Intellectual Property (IP) - Identification

- When an IP is acquired separately the cost of the copyright can usually be measured reliably.
- Where an IP is acquired in exchange for shares or other securities of an enterprise, the IP is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.
- Talent costs constitute a significant portion of cost of production of films. Talent costs could be in the form of -
  - Fixed compensation - which are added to the cost of IP.
  - Variable compensation (revenue share) - which expensed out evenly as the ultimate revenues are earned. Variable compensation is not added to the cost of IP.
  - Fixed + Revenue share - where the fixed costs are added to the cost of IP and revenue share is expensed out evenly as the ultimate revenues are earned.

Accounting for Intellectual Property (IP) - Amortization

- Benefits of IP exploitation extends across years and accordingly the cost of the IP should be allocated over the best estimate of its useful life.

- As per AS 26, there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use.

- Amortisation should commence when the IP is available for use.

- If control over the future economic benefits from the IP has been granted for a finite period, the useful life of the IP should not exceed the period of the legal rights unless:
  - The legal rights are renewable; and
  - Renewal is virtually certain.

- Amortisation methods adopted by a film producer and broadcaster are different and could be based on -
  - Straight line basis
  - Revenue forecast method
  - Appropriate method after considering the nature and stream of revenue

Accounting for Intellectual Property (IP) - Amortization

Film producer

- Amortise in the ratio of expected revenues from a revenue stream to the total expected revenues from the film.

- For example, films can be exploited in theatres, satellite TV, home entertainment, etc. On theatrical exploitation, the cost of IP should be amortised in the ratio of expected revenues from theatres to the total expected revenues from all sources.

Other source of guidance for understanding IP amortisation:

- In May 2014, the IASB issued amendments to IAS 38 significantly limiting the use of revenue-based amortisation for intangible assets. (Similar guidance under Ind AS 38)

- As per the provisions of rule 9A and 9B of the Income tax Act 1961
  - Full cost of production (COP) is allowed as a deduction if the movie is released 90 days prior to the year end and the exhibitor / producer sells all the rights of exhibition
  - If the movie is not released 90 days prior then proportionate COP equivalent to the revenues earned is allowed as deduction in the financial year and remaining COP is allowed in the subsequent financial year.

Accounting for Intellectual Property (IP) - Amortization

Broadcaster

- Television series:

A larger portion of the programme cost should be amortized in the first exploitation as the maximum benefit accrues in the first airing. Generally, the entire cost is amortised over two airings.

- Films:

For specific showing, IP amortized based on showings. For unlimited showings, IP amortized over a period of the agreement.

- Live Events:

Telecast method/ straight line method is often used for live sporting events, particularly for longer events such as a cricket world cup or a football season.

A broadcaster is eligible for tax deduction on the acquisition costs over the licence/ amortisation period.

Accounting for Intellectual Property (IP) - Impairment

- As per AS 28 an asset or group of assets generating cash (termed as a "cash generating unit") is impaired if its carrying amount exceeds its net selling price or its "value in use" and accordingly an impairment loss should be recognized.
- An impairment assessment should be performed on an annual basis and the basis used for amortisation should be re-assessed.
- Issue arises on impairment assessment of a flop movie or an intangible asset which is not available for use (Example, movie in progress; past research stage).

Film producer

- Impairment assessment is done for each film / IP separately.

Broadcaster

- IPs purchased for individual programmes are not considered separately.
- The entire channel is a CGU and impairment will have to be assessed based on the value in use for all the programmes put together for the entire channel.
- If the value in use of the CGU unit (channel) is lower than carrying amount of its assets, then the impairment loss should be recognised and should be allocated to reduce the carrying amount each assets of the CGU on a pro-rata basis.

Other Issues

Contracts with Deferred Payment Terms

How revenue should be recognised for contracts involving deferred payment terms ?

- Companies generally enter into syndication deals for selling movies, television episodes, etc. which are long term in nature and may range from two to five years.
- In case of such contracts, it is possible that payments are over an extended period of time.

No specific guidance under AS 9 Revenue Recognition

- Under Indian GAAP, the companies recognise the trade receivable at its nominal amount.

Other source of guidance:

- However, under Ind AS 115, if a contract is deemed to include a significant financing component, then the company will need to adjust the transaction price to reflect the time value of money.
- Hence, for applying Ind AS 115, companies in India would need to:
  - Review all the contracts that span a period longer than one year
  - Exercise judgement in assessing whether a significant financing component exists
  - Determine the processes for estimating the discount rates

Marketing / Publicity Costs

Accounting treatment for marketing and publicity costs incurred for promotion of films/ books/ programmes ?

- Film producers, publishers, broadcasters incur significant ad-spends for promotion of their films / books / programmes.
- The expenses incurred are accumulated and expensed/amortised partially or in full on the release of their entertainment product.

Accounting guidance – AS 26 Intangible Assets

- Marketing costs incurred for promoting an entertainment product do not meet the criteria of intangible asset, i.e. these do not have any future economic benefits.
- Accordingly, marketing should be expensed immediately when incurred
- Example: If a film releases in the first week of April 2015, all the marketing and publicity costs incurred up to March 31, 2015 are expensed off in the year 2014-15.

Thank You