

2011 FASB Exposure Draft: *Revenue from Contracts with Customers*

Introduction

Revenue from Contracts with Customers is a collective effort of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to reconcile inconsistencies between U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs) for revenue recognition. The publication is intended to simplify the accounting process by improving and reducing in number the revenue recognition requirements.

Issued November 14, 2011, this draft is a revision of the original Exposure Draft issued on June 24, 2010 and includes several significant changes. These changes may have a considerable impact on accounting processes related to the media, entertainment, technology, and telecommunications industries. The following areas highlight proposed changes which are anticipated to affect these industries:

Intellectual Property Licenses

The media, entertainment, technology, and telecommunications industries often license the rights to use intellectual property to third parties. Revenue from licenses is recognized upfront in current practices, while the proposed model stresses that revenue may only be recognized when an entity is reasonably assured to be entitled to a fee. The timing of current revenue recognition practices related to licensing intellectual property may be affected as a result.

A distinction made in the 2010 draft between exclusive and non-exclusive licenses was removed from the 2011 draft. The 2011 draft states that revenue should be recognized when the performance obligation is satisfied, regardless of the exclusivity of the license.

Variable Consideration

Variable consideration is a potential addition to a guaranteed minimum payment in agreements often used in media, entertainment, technology, telecommunications, and a variety of other industries. Types of variable

considerations include royalties, future discounts, incremental payments, rebates, and performance bonuses.

The transaction price is the amount to which an entity expects to be entitled. In current practice, only non-contingent transaction prices are accounted for. The proposed model states that any amount “to which the entity is reasonably assured to be entitled” should be accounted for. This is a change from the previous draft in which constraints on variable prices were limited to transactions in which “the price can be reasonably estimated.”

The proposed model stated that this estimate is to be based upon either the probability-weighted amount or the most likely amount. This is an addition to the 2010 draft, which suggested that the estimate be based solely upon the probability-weighted amount.

It should be noted that royalties and other such variable consideration that depend directly on future sales will not be significantly impacted, as they are not reasonably assured to be entitled to those amounts. In those cases, revenue recognition will not take place until the sale has occurred, as is the case in current practices.

Multiple Performance Obligations

The media, entertainment and technology industries often offer multiple performance obligations, or promises to deliver goods or perform services, in one bundle. The Exposure Draft changes the criteria from current practice for determining whether multiple performance obligations should be accounted for separately. According to the proposed model, if the customer can benefit from the good or service independently, then it should be accounted for separately. If the goods and services are highly interrelated, it should be accounted for as one bundle. This change could result in the recognition of more performance obligations than under current practices.

In the original draft, distinct performance obligations were determined by whether they had a distinct profit margin. This criterion was eliminated in the current draft, which defines a distinct performance obligation by whether it can be sold separately by the entity or whether it can be used with other resources readily available to the customer.

Return Rights

In the sale of most goods, customers are offered the right to return those goods to retailers. Revenue is recognized when an entity is reasonably assured of the amount of goods that will be returned. In current practice, refund obligations are recognized as a contra-asset. Contra-assets are accounts with credit balances such as accumulated depreciation and allowances for doubtful accounts. The Exposure Draft proposes that this obligation is instead recognized as a liability. Returned goods should be recognized as an asset initially measured at the original cost of goods, with a corresponding adjustment to cost of sales. There were no significant changes in this proposed model from the original Exposure Draft.

Contract Costs

U.S. GAAP offers extensive guidance to the media and entertainment industries on various industry-specific ways to account for contract costs. Types of contract costs impacted include costs associated with motion pictures or television series development, advance royalties paid to performing artists, and costs associated with pre-publication of books. The Exposure Draft simplifies these guidelines, stating that contracts should either be accounted for under the standards within which they fall (e.g. fixed assets, intangibles), or should be recognized as an asset. A contract can only be recognized as an asset if it does not fall within the scope of other standards; and if the costs related directly to a contract, relate to future activity, and are expected to be recovered.

In the original draft, the costs to obtain a contract were supposed to be expensed as incurred. The current draft proposes that the cost of obtaining a contract be capitalized if the cost is expected to be recovered and the amortization period of the cost is more than a year.

The exposure draft also discusses accounting for promotional programs and options on further acquisitions of goods and services.

For more information or questions regarding this or any other FASB exposure draft or codification, please feel free to contact any of the principals of Bond & Pecaro, Inc.