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Media sector

Clearly IFRS

Industry insights for IFRS 15

New revenue Standard could have a major impact on profile of revenue and profit recognition and may require system changes

What's happened?

The International Accounting Standards Board (IASB) has published a new Standard, IFRS 15 Revenue from Contracts with Customers ('the new Standard'). The new Standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, which is found currently across several Standards and Interpretations within IFRSs. The core principle is that an entity recognises revenue to reflect the transfer of goods or services, measured as the amount to which the entity expects to be entitled in exchange for those goods or services.

The new Standard is effective for reporting periods beginning on or after January 1, 2017, with earlier application permitted. Entities can choose to apply the Standard retrospectively or use a modified approach in the year of application. It is the result of a convergence project with the US Financial Accounting Standards Board (FASB) that began in 2002. Almost fully converged, the most significant differences between IFRSs and US GAAP relate to interim disclosures and timing of adoption.

Implications for the media sector

Below, we highlight certain key impacts resulting from the new Standard that will be of particular interest to those in the media sector and then consider parts of the new Standard that may contribute to those impacts. Of course many more complexities exist and, as described below, Deloitte has produced further guidance which explores these in greater detail.

How might this affect you?

The timing of revenue and profit recognition may be significantly affected by the new Standard

Whereas previously IFRSs allowed significant room for judgement in devising and applying revenue recognition policies and practices, IFRS 15 is more prescriptive in many areas relevant to the media sector. Applying these new rules may result in significant changes to the profile of revenue and, in some cases, profit recognition. This is not merely a financial reporting issue. As well as **preparing the market and educating analysts** on the impact of the new Standard, entities will need to consider wider implications. Amongst others, these might include:

- changes to **key performance indicators** and other **key metrics**;
- changes to the **profile of tax cash payments**;
- availability of **profits for distribution**;
- for **compensation and bonus plans**, impact on the timing of targets being achieved and the likelihood of targets being met; and
- potential non-compliance with **loan covenants**.

Headlines

The **profile of revenue and profit recognition** will change for some entities as the new Standard is more detailed and more prescriptive than the existing guidance and introduces new complexities. In particular, media companies will need to consider:

- whether revenue should be recognised **over time** or at **a point in time**;
- the impact of new guidance where pricing mechanisms include **variable amounts**;
- the extent to which **distinct goods or services** are supplied, which should be accounted for separately;
- the **types of licences** that are sold and whether the accounting treatment will need to change;
- the appropriate accounting for customer options to acquire **additional goods or services at a discount**; and
- whether current accounting policies for **barter transactions** will continue to be appropriate.

The new Standard requires significantly more **disclosures** relating to revenue and entities will need to ensure that **appropriate processes** are in place to gather the information.

Current accounting systems and processes may require significant changes to cope with the new Standard

As explained below, IFRS 15 introduces new requirements to move to a more conceptual approach. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard in the media sector may require modifications to existing accounting systems, and those entities in the sector who have a very large number of contracts and a multitude of product offerings may conclude that they need to develop new systems solutions. The availability of a 'portfolio approach' in some circumstances may reduce this additional complexity, but it will not be eliminated.

In determining the extent to which systems modifications will be required, entities will wish to consider the need for sufficient flexibility to cope with future changes in the pricing and variety of product offerings made to customers. The January 1, 2017 effective date may set a challenging timeframe for developing new systems.

What are the most significant changes?

Should revenue be recognised over time or at a point in time?

IFRS 15 introduces a new approach to determine whether revenue should be recognised over time or at a point in time. Three scenarios are specified in which revenue will be recognised over time – broadly, they are when (i) the customer receives and consumes the benefits of the seller's performance as the seller performs; (ii) the seller is creating a 'work in progress' asset which is controlled by the customer; and (iii) the seller is creating a 'work in progress' asset which could not be directed to a different customer and in respect of which the customer has an obligation to pay for the entity's work to date. If revenue is to be recognised over time, a method should be used which best reflects the pattern of transfer of goods or services to the customer. If a transaction does not fit into any of the three scenarios described above, revenue will instead be recognised at a point in time, when control passes to the customer.

By way of example, whether a production company can recognise revenue over time or at a point in time will often depend on a careful analysis of specific contract terms, with relatively small differences between otherwise similar contracts potentially having a fundamental impact on the timing of revenue recognition. It will often be particularly important to focus on contractual terms that allow the customer to cancel, curtail or significantly modify a contract and whether, in such cases, the seller is entitled to adequate compensation for work performed to date.

When should variable or uncertain revenues be recognised?

Contracts in the media sector often include significant variable elements, for example, a developer of a television programme may receive a percentage of advertising revenue from the broadcaster which is unknown at initial point of sale. There are new specific requirements in respect of variable consideration such that it is only included in the transaction price if it is highly probable that the amount of revenue recognised would not be subject to significant future reversals as a result of subsequent re-estimation. This approach to variable and contingent consideration is different from that previously reflected in IFRSs and, in certain scenarios, will require a significant degree of judgement to estimate the amount of consideration that should be taken into account. Accordingly, the profile of revenue recognition may change for some entities as a result.

The Standard also introduces a specific restriction for royalty payments relating to intellectual property. If royalty payments are based on usage or onward sale, entities are restricted from recognising the associated revenue until the usage or onward sale has occurred, even if it is possible to make a reliable estimate of this amount based on historical evidence.

How to identify and allocate revenue to different goods and services

Previously, given the lack of specific guidance in IFRSs, there was greater room for judgement when identifying the goods and services within a contract and then allocating the revenue to those goods and services. Entities may have to amend their current accounting policies as a result of the more detailed guidance in IFRS 15. The new Standard requires the revenue from a contract to be allocated to each distinct good or service provided on a relative standalone selling price basis, though a 'residual' approach is permitted in limited circumstances.

Media companies often offer bundles of goods and services to their customers. For example a multimedia advertising campaign may include more than one type of advertising placement such as print, online and television. Another example is where a newspaper has a subscription that includes access to both a print and online version of the publication. Applying the new Standard to these types of scenario, entities will need to assess whether the goods and services provided represent separate performance obligations or whether they should be accounted for as one performance obligation. Where it is concluded that certain goods or services should be accounted for separately, entities will then typically look to the standalone selling price to apportion the relevant amount of the transaction price to each distinct good or service.

Will this impact revenue allocated to the sale of set-top boxes and similar items?

Within the media sector it is not uncommon for equipment provided as part of a package to be subsidised by the providers of the channels and to be viewed as a cost of doing business. Previously, the lack of specific guidance in IFRSs, as noted above, has often led to any revenue allocated to the equipment being limited to the amount, if any, explicitly paid by the customer towards the equipment. If the equipment qualifies as distinct under IFRS 15, the new requirements discussed above to allocate revenue based on a relative standalone selling price will typically mean the recognition of more revenue at the start of the contract (when the equipment is delivered) and less over the term of the contract (as access to channels is provided).

The new requirements for allocating revenue may significantly change the profile of revenue recognition for some entities and due to the sheer volume of customers with different tariffs and service plans, entities may have to overcome significant practical challenges to ensure systems are in place to deal with the new requirements.

Will the type of licence sold impact when revenue is recognised?

IFRS 15 distinguishes between licences that represent the transfer of a right to use an entity's intellectual property and licences that represent the provision of access, over a period of time, to an entity's intellectual property, and specifies criteria to determine which type of licence is being sold. Revenue for the former will typically be recognised at a point in time; revenue for the latter will typically be recognised over the period of access. Entities within the media sector will need to examine licence arrangements in the light of this new guidance, and may need to change their existing accounting in some cases. Where a change is required, this may have a significant impact on the timing of revenue recognition.

Should revenue be allocated to customer options to acquire additional goods or services at a discount?

Some media contracts include a right for the customer to purchase additional goods or services at a discount, for example, in a subscription package if renewal fees are significantly lower than first year fees, or where a renewal option is granted to a network by a production company in respect of a TV series. If a contract includes a material right for the customer to acquire additional goods or services, an entity must allocate a portion of the transaction price to that option and recognise revenue when control of the goods or services underlying the option is transferred to the customer, or when the option expires.

Will accounting for barter transactions change as a result of the new Standard?

It is not uncommon for a media entity to exchange advertising space with another media entity for nil cash consideration. The specific guidance regarding how to account for such transactions has now been superseded by more general accounting principles in the new Standard. Entities will have to consider whether this new guidance, particularly on non-cash consideration and non-monetary exchanges between entities, will require a change from their current accounting policies for such transactions.

What else might change?

In addition to the key changes discussed above, the new Standard introduces detailed guidance in many areas regarding the reporting of revenue and entities will need to ensure that they have considered all of these when assessing the extent to which their accounting policy for revenue may need to be amended.

Getting started

Some effective first steps to consider as you begin to evaluate the implications of the new Standard include:

- Evaluating significant revenue streams and key contracts to identify the specific revenue recognition changes required and the specific business units where these changes may have the greatest impact.
- Addressing the longer lead-time areas where new calculation engines or revised allocation processes may be required.
- Establishing a granular project plan and roadmap to manage the effort across multiple business units and countries.

How Deloitte can help

Deloitte has an experienced team of professionals, both in Canada and globally across the member firms of Deloitte Touche Tohmatsu Limited, who can assist in developing an action plan to help you implement the new revenue recognition standard.

These capabilities include the full breadth of services and competencies needed to help clients address these issues, and would include accounting interpretative assistance, help with process revisions, support in making system changes (including development of system business requirements), tax and other matters.

More detailed information on the impact of IFRS 15 can be found in Deloitte's IFRS in Focus publication available from www.iasplus.com. Further industry publications are also available here.

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