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Accounting by producers or distributors of films; Statement of position 00-2;

American Institute of Certified Public Accountants. Accounting Standards Executive Committee

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**STATEMENT OF
POSITION 00-2**

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

June 12, 2000

**Accounting by Producers or
Distributors of Films**

*Issued by the
Accounting Standards Executive Committee*

NOTE

Statements of Position on accounting issues present the conclusions of at least two thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*, identifies AICPA Statements of Position that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category *b* of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this Statement of Position if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the Statement of Position should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

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SUMMARY

This Statement of Position (SOP) provides guidance on generally accepted accounting principles for all kinds of films, except where specifically noted, and is applicable to all producers or distributors that own or hold rights to distribute or exploit films. For purposes of this SOP, films are defined as feature films, television specials, television series, or similar products (including animated films and television programming) that are sold, licensed, or exhibited, whether produced on film, video tape, digital or other video recording format. The SOP requires, among other things, the following.

- An entity should recognize revenue from a sale or licensing arrangement of a film when all of the following conditions are met.
 - Persuasive evidence of a sale or licensing arrangement with a customer exists.
 - The film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery.
 - The license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale.
 - The arrangement fee is fixed or determinable.
 - Collection of the arrangement fee is reasonably assured.

If an entity does not meet any one of the preceding conditions, the entity should defer recognizing revenue until all of the conditions are met.

- If a licensing arrangement covering a single film provides that an entity will receive a flat fee, then the amount of that fee is considered fixed and determinable. In such instances, the entity should recognize the entire amount of the license fee as revenue when it has met all of the other revenue recognition conditions.

- An entity's arrangement fee may be based on a percentage or share of a customer's revenue from the exhibition or other exploitation of a film. In such instances, and when the entity meets all of the other revenue recognition conditions, the entity should recognize revenue as the customer exhibits or exploits the film.
- In certain licensing arrangements that provide for variable fees, a customer guarantees and pays or agrees to pay an entity a nonrefundable minimum amount that is applied against the variable fees on a film or films that are not cross-collateralized. In such arrangements, the amount of the nonrefundable minimum guarantee is considered fixed and determinable, and the entity should recognize the minimum guarantee as revenue when it has met all of the other revenue recognition conditions.
- If a licensing arrangement provides for a nonrefundable minimum guarantee that is applied against variable fees from a group of films on a cross-collateralized basis, the amount of the minimum guarantee applicable to each film cannot be objectively determined. Consequently, the entity should recognize revenue as the customer exhibits or exploits the film. If, at the end of the license period, a portion of the nonrefundable minimum guarantee remains unearned, an entity should recognize the remaining guarantee as revenue by allocating it to the individual films based on their relative performance under the arrangement.
- The costs of producing a film and bringing that film to market consist of film costs, participation costs, exploitation costs, and manufacturing costs.
- An entity should report film costs as a separate asset on its balance sheet.
- An entity should amortize film costs and accrue (expense) participation costs using the individual-film-forecast-computation method, which amortizes or accrues (expenses) such costs in the same ratio that current period actual revenue (numerator) bears to

estimated remaining unrecognized ultimate revenue as of the beginning of the current fiscal year (denominator). An entity should begin amortization of capitalized film costs and accrual (expensing) of participation costs when a film is released and it begins to recognize revenue from that film.

- Ultimate revenue to be included in the denominator of the individual-film-forecast-computation method fraction is subject to the limitations set forth in this SOP.
- If an event or change in circumstance indicates that an entity should assess whether the fair value of a film is less than its unamortized film costs, the entity should determine the fair value of the film (the determination of which is affected by estimated future exploitation costs still to be incurred) and write off to the income statement the amount by which the unamortized capitalized costs exceeds the film's fair value. An entity should not subsequently restore any amounts written off in previous fiscal years.
- An entity should account for advertising costs in accordance with the provisions of SOP 93-7, *Reporting on Advertising Costs*. All other exploitation costs, including marketing costs, should be expensed as incurred.
- An entity should charge manufacturing and/or duplication costs of products for sale, such as videocassettes and digital video discs, to expense on a unit-specific basis when the related product revenue is recognized.
- This SOP is effective for financial statements for fiscal years beginning after December 15, 2000. Earlier application is encouraged. The cumulative effect of changes in accounting principles caused by adopting the provisions of this SOP should be included in the determination of net income in conformity with paragraph 20 of Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*. Disclosure of pro forma effects of retroactive application (APB Opinion 20, paragraph 21) is not required. An entity should not restate previously issued annual financial statements.

FOREWORD

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSEC's fifteen members, and (3) a proposed final document that has been approved by at least ten of AcSEC's fifteen members. The document is cleared if at least five of the seven FASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in its review of proposed projects and proposed documents include the following.

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.
2. The proposal will result in an improvement in practice.
3. The AICPA demonstrates the need for the proposal.
4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, prior to clearance, the FASB will propose suggestions, many of which are included in the documents.

Accounting by Producers or Distributors of Films

Introduction and Background

1. In 1981, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*. FASB Statement No. 53 extracted specialized accounting and reporting principles and practices from the American Institute of Certified Public Accountants (AICPA) Industry Accounting Guide *Accounting for Motion Picture Films*, and AICPA Statement of Position (SOP) 79-4, *Accounting for Motion Picture Films*, and established financial accounting and reporting standards for **producers or distributors** of films.¹
2. Since FASB issued FASB Statement No. 53, extensive changes have occurred in the film industry. Through 1981, the majority of a film's **revenue** resulted from distribution to movie theaters and free television. Since that time, numerous additional forms of exploitation (such as home video, satellite and cable television, and pay-per-view television) have come into existence, and international revenue has increased in significance. Concurrent with these changes, significant variations in the application of FASB Statement No. 53 have arisen.
3. In 1995, in response to concerns raised by constituents, the FASB requested that the AcSEC of the AICPA develop an SOP providing guidance on the accounting and financial reporting requirements for producers or distributors of films. In September 1998, the FASB concluded that it would rescind FASB Statement No. 53 when AcSEC completed its project. An **entity** that previously was subject to the requirements of FASB Statement No. 53 should follow the guidance

1. Terms defined in the glossary are set in boldface type the first time they appear in this SOP.

in this SOP. This SOP and FASB Statement No. 139, *Rescission of FASB Statement No. 53 and Amendments to FASB Statements No. 63, 89, and 121*, are simultaneously effective for fiscal years beginning after December 15, 2000.

4. AcSEC issued an exposure draft of a proposed SOP, *Accounting by Producers and Distributors of Films*, on October 16, 1998. AcSEC received twenty-eight comment letters in response to the exposure draft. See the section entitled “Basis for Conclusions” for a discussion of AcSEC’s response to the comment letters received.

Scope

5. The guidance in this SOP applies to all kinds of films, except where specifically noted below, and is applicable to all producers or distributors that own or hold rights to distribute or exploit films. For purposes of this SOP, films are defined as feature films, television specials, television series, or similar products (including animated films and television programming) that are sold, licensed, or exhibited, whether produced on film, video tape, digital, or other video recording format. This SOP does not apply to the following:
 - a. Activities or transactions within the scope of FASB Statement No. 50, *Financial Reporting in the Record and Music Industry* (For example, accounting for the creation and distribution of recorded music products is within the scope of FASB Statement No. 50, whereas accounting for the cost of acquiring music rights for use in a film is within the scope of this SOP.)
 - b. Activities or transactions within the scope of FASB Statement No. 51, *Financial Reporting by Cable Television Companies*
 - c. Activities or transactions within the scope of FASB Statement No. 63, *Financial Reporting by Broadcasters*
 - d. Activities or transactions within the scope of FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*

- e. Activities or transactions within the scope of SOP 97-2, *Software Revenue Recognition*
- f. Products within the scope of Emerging Issues Task Force (EITF) Issue No. 96-6, “Accounting for the Film and Software Costs Associated with Developing Entertainment and Educational Software Products”

Conclusions

Revenue Recognition—Basic Principles

6. A licensing arrangement for a single film or multiple films involves the transfer of a single right or a group of rights. An entity may license films to customers such as distributors, theaters, exhibitors, or other licensees on either an exclusive or nonexclusive basis in a particular **market and territory**. The terms of licensing arrangements may vary significantly from contract to contract. In common licensing arrangements, the license fee may be fixed in amount (flat fee) or may be based on a percentage of the customer’s revenue (variable fee). When based on a percentage of a customer’s revenue, an arrangement may include a **nonrefundable minimum guarantee**, which may be paid in advance or over a license period. The terms of a licensing arrangement may allow a producer to exercise direct control over the distribution of a film, or may transfer that control to a distributor, exhibitor, or other licensee.
7. An entity should recognize revenue from a **sale** or licensing arrangement of a film when all of the following conditions are met.
 - a. Persuasive evidence of a sale or licensing arrangement with a customer exists.
 - b. The film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery.
 - c. The license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale.
 - d. The arrangement fee is fixed or determinable.

- e. Collection of the arrangement fee is reasonably assured.

If an entity does not meet any one of the preceding conditions, the entity should defer recognizing revenue until all of the conditions are met.

8. If an entity recognizes a receivable in its balance sheet for advances presently due pursuant to an arrangement for any form of distribution, exhibition, or exploitation prior to the date of revenue recognition, or an entity receives cash payments under such an arrangement prior to revenue recognition, it should also recognize an equivalent liability for deferred revenue until the entity meets all of the conditions of paragraph 7. If an entity sells or otherwise transfers to a third party that receivable, the liability for deferred revenue established pursuant to the preceding sentence should not be reduced, and revenue for the film should not be recognized, until the conditions of paragraph 7 are met. Amounts scheduled to be received in the future pursuant to an arrangement for any form of distribution, exploitation, or exhibition should not be recognized as a receivable prior to the time those amounts are presently due or have been recognized as revenue pursuant to paragraph 7, if earlier.

Revenue Recognition—Details

Persuasive Evidence of an Arrangement

9. Persuasive evidence of a licensing arrangement is provided solely by a contract or other legally enforceable documentation that sets forth, at a minimum, the license period, the film or films affected, the rights transferred, and the consideration to be exchanged. An entity should not recognize revenue if factors raise significant doubt as to the obligation or ability of either party to perform under the terms of an arrangement.
10. An entity should have forms of verifiable evidence, such as a contract, a purchase order, or an online authorization, to document the mutual understanding of an arrangement. That evidence should include correspondence received from the customer that details the mutual understanding of the arrangement between the customer and the entity, or

evidence that the customer has acted in accordance with such arrangement.

Delivery

11. In a licensing arrangement that requires the physical delivery of a product to a customer, an entity should not recognize revenue until such delivery is complete. If a licensing arrangement is silent about delivery, physical delivery is required in order to recognize revenue.
12. Certain licensing arrangements may not require immediate or direct physical delivery of a film to a customer. In lieu of immediate delivery, an arrangement may provide the customer with immediate and unconditional access to a film print held by the entity or authorization for the customer to order a film laboratory to make the film immediately and unconditionally available for the customer's use (a lab access letter). In such cases, if the film is complete and available for immediate delivery, the entity has met the conditions of paragraph 7(b).
13. If a licensing arrangement requires an entity to make significant changes to a film after its initial availability to a customer, the arrangement does not meet the delivery condition in paragraph 7(b). In such instances, the entity should not recognize revenue until it makes those significant changes and meets all of the conditions of paragraph 7. Significant changes are defined as those changes that are additive to a film; that is, an arrangement requires an entity to create new or additional content after the film is initially available to the customer. For example, reshooting a scene or creating additional special effects are significant changes. Mere insertion or addition of preexisting film footage, addition of dubbing or subtitles (which by definition is done to existing footage), removal of offensive language, reformatting a film to fit a broadcaster's screen dimensions, and adjustments to allow for the insertion of commercials are all examples of changes to a film that are not significant and do not preclude revenue recognition prior to their completion. The costs incurred for significant changes should be added to **film costs** and subsequently charged to expense when an entity recognizes the related

revenue; the costs expected to be incurred for insignificant changes should be accrued and charged to expense if an entity begins to recognize revenue from the arrangement before incurring those costs.

Availability

14. Certain arrangements restrict a customer from beginning its initial exploitation, exhibition, or sale of a film. For example, the imposition of a street date (the initial date when home video products may be sold or displayed for rental) defines the period in time when a customer's exploitation rights begin. In such instances, an entity should not recognize related revenue until the restriction has expired. Additionally, if conflicting agreements impose restrictions on the initial exploitation, exhibition, or sale of a film by a customer in a particular territory or market, an entity should not recognize revenue until the restrictions lapse and it meets all of the other conditions of paragraph 7.

Fixed or Determinable Fee

15. **Flat Fees.** If a licensing arrangement covering a single film provides that an entity will receive a flat fee, then the amount of that fee is considered fixed and determinable. In such instances, the entity should recognize the entire amount of the license fee as revenue when it has met all of the other conditions of paragraph 7.
16. If a licensing arrangement provides for a flat fee payable with respect to multiple films (including films not yet produced or completed), an entity should allocate the amount of the fee to each individual film, by market and territory based on relative fair values of the rights to exploit each film under the licensing arrangement. An entity should base the allocations to a film or films not yet produced or completed on the amounts refundable if the entity does not ultimately complete and deliver the films to the customer. The entity should allocate the remaining flat fee to completed films based on the relative fair values of the rights to exploit those films pursuant to the licensing arrangement. Once made, those allocations should not be subject to later adjustment. An entity should recognize amounts allocated to individual films as revenue when it meets all of the con-

ditions of paragraph 7 with respect to each individual film by market and territory. If an entity cannot determine relative fair values of the rights to exploit those films, then the fee is not fixed or determinable and the entity should not recognize revenue until it can make such a determination and it meets all of the conditions of paragraph 7.

17. Paragraph 7 of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, provides a hierarchy of methods for determining fair value. Because quoted market prices (the most preferred method) are usually not available, an entity should estimate the fair value of the rights to exploit an individual film that is part of a multiple film arrangement (as discussed in paragraph 16) by using the best information available in the circumstances with the objective of measuring the amount the entity believes it would have received had it entered into a license arrangement that grants the same rights to the film separately rather than as part of the multiple film arrangement. A discounted cash flows model is often used to estimate fair value. Paragraphs 39 to 71 of FASB Statement of Financial Accounting Concepts No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, provide guidance on the traditional and expected cash flow approaches to present value measurements. An entity's estimates of cash flows used in determining the fair value of the rights to exploit an individual film that is part of a multiple film arrangement should be consistent with the rights granted for that film under the multiple film arrangement (for example, the length of the license period, and any limitations on the method, timing, or frequency of exploitation).
18. **Variable Fees.** An entity's arrangement fee may be based on a percentage or share of a customer's revenue from the exhibition or other exploitation of a film. In such instances, and when the entity meets all of the conditions of paragraph 7, the entity should recognize revenue as the customer exhibits or exploits the film.
19. **Nonrefundable Minimum Guarantees.** In certain licensing arrangements that provide for variable fees, a customer guarantees and pays or agrees to pay an entity a nonrefund-

able minimum amount that is applied against the variable fees on a film or films that are not **cross-collateralized**. In such arrangements, the amount of the nonrefundable minimum guarantee is considered fixed and determinable, and the entity should recognize the minimum guarantee as revenue when it has met all of the other conditions of paragraph 7.

20. If a licensing arrangement provides for a nonrefundable minimum guarantee that is applied against variable fees from a group of films on a cross-collateralized basis, the amount of the minimum guarantee applicable to each film cannot be objectively determined. Consequently, the entity should recognize revenue in such arrangements in accordance with the provisions of paragraph 18. If, at the end of the license period, a portion of the nonrefundable minimum guarantee remains unearned, an entity should recognize the remaining guarantee as revenue by allocating it to the individual films based on their relative performance under the arrangement.

Barter Revenue

21. An entity sometimes licenses programming to television stations in exchange for a specified amount of advertising time on those stations. These exchanges qualify as nonmonetary exchanges and an entity should account for these kinds of exchanges in accordance with Accounting Principles Board Opinion (APB) No. 29, *Accounting for Nonmonetary Exchanges*, as interpreted by EITF Issue No. 93-11, "Accounting for Barter Transactions Involving Barter Credits."

Modifications of Arrangements

22. If, at any time during a licensing arrangement, an entity and its customer agree to extend an existing arrangement (and all of the provisions in paragraph 7 are met), the accounting for the consideration received for the extension depends on whether the consideration is a flat fee or a variable fee. If the consideration is a flat fee, the entity should account for the consideration upon the execution of the extension in accordance with the provisions of paragraphs 15 and 16 of this SOP. If the consideration is a variable fee, the entity

should follow the guidance set forth in paragraph 18. If the consideration is a minimum guarantee, the entity should follow the guidance set forth in paragraphs 19 and 20.

23. If, at any time during a licensing arrangement, the parties agree to change the provisions of the licensing arrangement, other than by extending the license period (as discussed in paragraph 22), the entity should consider the revised arrangement as a new arrangement and account for it in accordance with the provisions of this SOP. At the time the old arrangement is terminated, the entity should accrue and expense associated costs or reverse previously reported revenue for refunds and concessions (an example of which is agreeing to a below market rate license fee), to terminate the old arrangement. For example, if an original arrangement was a fixed fee and the new arrangement is a smaller fixed fee with a variable component, the entity should reduce revenue for the current period for the excess of the original fixed fee previously reported as revenue over the new fixed fee and earned variable component to date. It should also adjust accumulated film cost amortization and accrued participation costs attributable to that excess. In addition, the entity should account for the new arrangement fee in accordance with this SOP.

Returns and Price Concessions

24. The contract provisions of an arrangement and an entity's policies and past actions related to granting concessions or accepting product returns can determine whether a fee is fixed or determinable. For an arrangement that includes a right-of-return provision or if an entity's past practices allow for returns, an entity must meet all of the conditions in FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*, in order for it to recognize revenue. Those conditions include a requirement that the entity can reasonably estimate the amount of future returns.
25. An example of how contractual provisions or an entity's customary business practices related to granting price concessions can affect the determination of revenue recognition is as follows. In the home video business, customers may be granted price concessions on previously purchased and un-

sold product if an entity subsequently reduces its wholesale prices (commonly referred to as price protection). In such cases, an entity should provide appropriate allowances at the date of revenue recognition. If an entity is unable to reasonably and reliably estimate future price concessions, or if significant uncertainties exist regarding an entity's ability to maintain its prices, the corresponding revenue is not fixed or determinable. Consequently, the entity should not recognize revenue until it can make reasonable and reliable estimates of the effects of future price changes.

Licensing of Film-Related Products

26. An entity should not recognize revenue from licensing arrangements to market film-related products until it releases the corresponding film.

Present Value

27. Revenue recognized in connection with a licensing arrangement should represent the present value of the license fee as of the date that an entity first recognizes the revenue, computed in accordance with APB Opinion 21, *Interest on Receivables and Payables*.

Costs and Expenses

28. The costs of producing a film and bringing that film to market consist of film costs, **participation costs**, **exploitation costs**, and manufacturing costs.

Film Costs—Capitalization

29. An entity should report film costs as a separate asset on its balance sheet. An entity should account for interest costs related to the production of a film in accordance with the provisions in FASB Statement No. 34, *Capitalization of Interest Cost*.
30. Production overhead, a component of film costs, includes allocable costs of individuals or departments with exclusive or significant responsibility for the production of films. Production overhead should not include administrative and general expenses, the costs of certain overall deals, as

discussed in paragraph 31, or charges for losses on properties sold or abandoned, as discussed in paragraph 32.

31. An entity may enter into an arrangement known as an *overall deal*, whereby it compensates a producer or other creative individual for the exclusive or preferential use of that party's creative services. An entity should charge the costs of overall deals that cannot be identified with specific projects to expense as they are incurred over the related period of time. An entity should record a reasonable proportion of costs of overall deals as specific project film costs to the extent those costs are directly related to the acquisition, adaptation, or development of specific projects. If related to properties as discussed in paragraph 32, an entity should include such amounts in the cost of properties subject to the periodic review. An entity should not allocate to specific project film costs amounts that it had previously expensed.
32. Film costs ordinarily include expenditures for properties (such as film rights to books or stage plays, or original screenplays) that generally must be adapted to serve as the basis for the production of a particular film. An entity will add the cost of adaptation or development to the cost of the particular property. An entity should periodically review properties in development to determine whether they will ultimately be used in the production of a film. When an entity determines that a property will not be used (disposed of), it should recognize any loss by a charge to the income statement. It should be presumed that an entity will dispose of a property (whether by sale or abandonment) if it has not been set for production within three years from the time of the first capitalized transaction. An entity should measure the loss as the amount by which the carrying amount of the project exceeds its fair value. Amounts written off should not be subsequently reestablished as assets. Unless management, having the authority to approve the action, has committed to a plan to sell such property, the rebuttable presumption is that the entity will abandon the property and, as such, its fair value should be zero.
33. For an episodic television series, the following additional guidance for film costs applies. Ultimate revenue for an episodic television series can include estimates from the

initial market and secondary markets, as discussed in paragraph 39(b).² Until an entity can establish estimates of secondary market revenue in accordance with paragraph 39(b), capitalized costs for each episode produced should not exceed an amount equal to the amount of revenue contracted for that episode. An entity should expense as incurred film costs in excess of this limitation on an episode-by-episode basis, and an entity should not restore such amounts as film cost assets in subsequent periods. An entity should expense all capitalized costs (including set costs) for each episode as it recognizes the related revenue for each episode. Once an entity can establish estimates of secondary market revenue in accordance with paragraph 39(b), the entity should capitalize subsequent film costs. An entity should amortize such capitalized film costs in accordance with the provisions in paragraphs 34 through 37, and it should evaluate such costs for impairment in accordance with paragraph 44.

Film Costs Amortization; Participation Cost Accruals

34. An entity should amortize film costs and accrue (expense) participation costs using the individual-film-forecast-computation method, which amortizes or accrues (expenses) such costs in the same ratio that current period actual revenue (numerator) bears to estimated remaining unrecognized ultimate revenue as of the beginning of the current fiscal year (denominator). That is, (a) unamortized film costs as of the beginning of the current fiscal year are multiplied by the individual-film-forecast-computation method fraction and (b) unaccrued (that is, not yet expensed) ultimate participation costs at the beginning of the current fiscal year are multiplied by the individual-film-forecast-computation method fraction. In this way, in the absence of changes in estimates, film costs are amortized and participation costs are accrued (expensed) in a manner that yields a constant rate of profit over the ultimate period, as described in paragraph 39(a), for each film before exploitation costs, manu-

2. In this context, *initial market* is the first market of exploitation in each territory, whether that market is a broadcast or cable television network, first-run syndication, or other. *Secondary markets* are any markets other than the initial market.

facturing costs, and other period expenses. An entity should accrue a liability for participation costs only if it is probable that there will be a sacrifice of assets to settle its obligation under the terms of the participation agreement. At each balance sheet date, accrued participation costs should not be less than the amounts that an entity is obligated to pay as of that date. An entity should begin amortization of capitalized film costs and accrual (expensing) of participation costs when a film is released and it begins to recognize revenue from that film.

35. In the absence of revenue from third parties that is directly related to the exhibition or exploitation of a film, an entity should make a reasonably reliable estimate of the portion of unamortized film costs that is representative of the utilization of the film in that exhibition or exploitation. An entity should expense such amounts as it exhibits or exploits the film. (For example, a cable entity that does not accept advertising on its cable channel may produce a film and show it on that channel. In this example, the cable entity receives subscription fees from third parties that are not directly related to a particular film.) Consistent with the underlying premise of the individual film-forecast-computation method, all revenue should bear a representative amount of the amortization of film costs during the ultimate period.
36. As a result of uncertainties in the estimating process, actual results may vary from estimates. An entity should review and revise estimates of ultimate revenue and participation costs as of each reporting date to reflect the most current available information. If estimates are revised, an entity should determine a new denominator that includes only the ultimate revenue from the beginning of the fiscal year of change (that is, ultimate revenue changes are treated prospectively as of the beginning of the fiscal year of change). The numerator (revenue for the current fiscal year) is unaffected by the change. An entity should apply the revised fraction to the net carrying amount of unamortized film costs and to the film's unaccrued (that is, not yet expensed) ultimate participation costs as of the beginning of the fiscal year, and the difference between expenses deter-

mined using the new estimates and any amounts previously expensed during that fiscal year should be charged or credited to the income statement in the period (for example, the quarter) during which the estimates are revised.

37. Multiple seasons of an episodic television series that meets the conditions of paragraph 39(b) to include estimated secondary market revenue in ultimate revenue is considered to be a single product, with multiple seasons of the series combined for purposes of applying the individual film-forecast-computation method.

Ultimate Revenue

38. Ultimate revenue to be included in the denominator of the individual-film-forecast-computation method fraction should include estimates of revenue that is expected to be recognized by an entity from the exploitation, exhibition, and sale of a film in all markets and territories, subject to the limitations set forth in paragraph 39.
39. Ultimate revenue should be limited by the following.
 - a. For films other than episodic television series, ultimate revenue should include estimates over a period not to exceed ten years following the date of the film's initial release. For episodic television series, ultimate revenue should include estimates of revenue over a period not to exceed ten years from the date of delivery of the first episode or, if still in production, five years from the date of delivery of the most recent episode, if later. For previously released films acquired as part of a film library, ultimate revenue should include estimates over a period not to exceed twenty years from the date of acquisition. For purposes of this SOP, an entity should categorize as part of a film library only those individual films whose initial release dates were at least three years prior to the acquisition date.
 - b. For episodic television series, ultimate revenue should include estimates of secondary market revenue (that is, revenue from markets other than the initial market) for produced episodes only if an entity can demon-

strate through its experience or industry norms that the number of episodes already produced, plus those for which a **firm commitment** exists and the entity expects to deliver, can be licensed successfully in the secondary market.

- c. Ultimate revenue should include estimates of revenue from a market or territory only if persuasive evidence exists that such revenue will occur, or if an entity can demonstrate a history of earning such revenue in that market or territory. Ultimate revenue should include estimates of revenue from newly developing territories only if an existing arrangement provides persuasive evidence that an entity will realize such amounts.
- d. Ultimate revenue should include estimates of revenue from licensing arrangements with third parties to market film-related products only if persuasive evidence exists that such revenue from that arrangement will occur for that particular film (such as a signed contract to receive a nonrefundable minimum guarantee or a nonrefundable advance) or if an entity can demonstrate a history of earning such revenue from that form of arrangement.
- e. Ultimate revenue should include estimates of the portion of the wholesale or retail revenue from an entity's sale of peripheral items (such as toys and apparel) that is attributable to the exploitation of themes, characters, or other contents related to a particular film only if the entity can demonstrate a history of earning such revenue from that form of exploitation in similar kinds of films. For example, an entity may conclude that the portion of revenue from the sale of peripheral items that it should include in ultimate revenue is an estimate of what would be earned by the entity if rights for such form of exploitation had been granted under licensing arrangements with third parties. Ultimate revenue should not, however, include estimates of the entire amount of wholesale or retail revenue from an entity's sale of peripheral items.

- f.* Ultimate revenue should not include estimates of revenue from unproven or undeveloped technologies.
 - g.* Ultimate revenue should not include estimates of wholesale promotion or advertising reimbursements to be received from third parties; an entity should offset such amounts against exploitation costs.
 - h.* Ultimate revenue should not include estimates of amounts related to the sale of film rights for periods after those identified in paragraph 39(a).
40. An entity should not discount ultimate revenue to its present value except as required by the provisions in paragraph 27. All foreign currency estimates of future revenues should be based on current spot rates. Ultimate revenue should not include amounts representing projections for future inflation.

Ultimate Participation Costs

41. Estimates of unaccrued (that is, not yet expensed) ultimate participation costs are used in the individual-film-forecast-computation method to arrive at current period participation cost expense. Such costs should be determined using assumptions that are consistent with an entity's estimates of film costs, exploitation costs, and ultimate revenue, as limited by the provisions in paragraph 39. If, at any balance sheet date, the recognized participation costs liability exceeds the estimated unpaid ultimate participation costs for an individual film, the excess liability should be reduced with an offsetting credit to unamortized film costs. To the extent that an excess liability exceeds unamortized film costs for that film, it should be credited to income.
42. A film may continue to generate revenue after its film costs are fully amortized. When revenue is recorded on fully amortized films, an entity should accrue associated participation costs as that revenue is recognized.

Film Costs Valuation

43. The following are examples of events or changes in circumstances that indicate that an entity should assess whether

the fair value of a film (whether completed or not) is less than its unamortized film costs.

- a.* An adverse change in the expected performance of a film prior to release
 - b.* Actual costs substantially in excess of budgeted costs
 - c.* Substantial delays in completion or release schedules
 - d.* Changes in release plans, such as a reduction in the initial release pattern
 - e.* Insufficient funding or resources to complete the film and to market it effectively
 - f.* Actual performance subsequent to release fails to meet that which had been expected prior to release
44. If an event or change in circumstance indicates that an entity should assess whether the fair value of a film is less than its unamortized film costs, the entity should determine the fair value of the film (the determination of which is affected by estimated future exploitation costs still to be incurred) and write off to the income statement the amount by which the unamortized capitalized costs exceeds the film's fair value. Exploitation costs incurred after such a write-off should be accounted for in accordance with the provisions of paragraph 49. An entity should treat the reduced amount of capitalized film costs that have been written down to fair value at the close of an annual fiscal period as the cost for subsequent accounting purposes, and an entity should not subsequently restore any amounts previously written off.
45. As discussed in paragraph 17, a discounted cash flows model is often used to estimate fair value. If applicable, future cash flows based on the terms of any existing contractual arrangements, including cash flows over existing license periods without consideration of the limitations set forth in paragraph 39, should be included. An entity should consider the following factors, among others, in estimating future cash inflows for a film: (*a*) if previously released, the film's performance in prior markets, (*b*) the public's perception of the film's story, cast, director, or producer, (*c*) historical results of similar films, (*d*) historical results of the cast,

director, or producer on prior films, and (e) running time of the film. In determining a film's fair value, it is also necessary to consider those cash outflows necessary to generate the film's cash inflows. Therefore, an entity should incorporate, if applicable, its estimates of future costs to complete a film, future exploitation and participation costs, or other necessary cash outflows in its determination of fair value when using a discounted cash flows model.

46. When using the traditional discounted cash flow approach to estimate the fair value of a film, the relevant future cash inflows and outflows should represent the entity's estimate of the most likely cash flows. When determining the fair value of a film using the expected cash flows approach, all possible relevant future cash inflows and outflows should be probability weighted by period and the estimated mean or average by period should be used.
47. When determining the fair value of a film using a traditional discounted cash flow approach, the discount rate(s) should not be an entity's incremental borrowing rate(s), liability settlement rate(s), or weighted average cost of capital as those rates typically do not reflect the risks associated with a particular film. The discount rate(s) should consider the time value of money and the expectations about possible variations in the amount or timing of the most likely cash flows and an element to reflect the price market participants would seek for bearing the uncertainty inherent in such an asset as well as other factors, sometimes unidentifiable, including illiquidity and market imperfections. When determining the fair value of a film using the expected cash flow approach, the discount rate(s) also would consider the time value of money. Because they are reflected in the expected cash flows, there would be no adjustment for possible variations in the amounts or timing of those cash flows. If not reflected in risk-adjusted expected cash flows, an additional element to reflect the price market participants would seek for bearing the uncertainty inherent in such an asset as well as other factors, sometimes unidentifiable, including illiquidity and market imperfections, should be added to the discount rate(s).

Subsequent Events

48. For films released before or after the date of the balance sheet for which evidence of the possible need for a write-down of unamortized film costs occurs after the date of the balance sheet but before an entity issues its financial statements, a rebuttable presumption exists that the conditions leading to the write-off existed at the date of the balance sheet. In such situations, an entity should adjust its financial statements for the effect of any changes in estimates resulting from the use of the subsequent evidence. An entity can overcome the rebuttable presumption if it can demonstrate that the conditions leading to the write-down did not exist at the date of the balance sheet.

Exploitation Costs

49. An entity should account for advertising costs in accordance with the provisions of SOP 93-7, *Reporting on Advertising Costs*. All other exploitation costs, including marketing costs, should be expensed as incurred.

Manufacturing Costs

50. An entity should charge manufacturing and/or duplication costs of products for sale, such as videocassettes and digital video discs, to expense on a unit-specific basis when the related product revenue is recognized. An entity should, at each balance sheet date, evaluate inventories of such products for net realizable value and obsolescence exposures, with appropriate adjustments recorded as necessary. An entity should charge the cost of theatrical **film prints** to expense over the period benefited.

Presentation and Disclosure

51. If an entity presents a classified balance sheet, it should classify film costs as noncurrent on the face of the balance sheet. Regardless of whether an entity presents a classified or unclassified balance sheet, it should disclose in the notes to the financial statements the portion of the costs of its completed films that are expected to be amortized during the upcoming operating cycle, which is presumed to be

twelve months. An entity should disclose its operating cycle if it is other than twelve months.

52. An entity should disclose the components of film costs (including released, completed and not released, in production, or in development or preproduction) separately for theatrical films and direct-to-television product.
53. An entity should disclose the percentage of unamortized film costs for released films, excluding acquired film libraries, that it expects to amortize within three years from the date of the balance sheet. If that percentage is less than 80 percent, an entity should provide additional information, including the period required to reach an amortization level of 80 percent. For acquired film libraries, an entity should disclose the amount of remaining unamortized costs, the method of amortization, and the remaining amortization period.
54. An entity should disclose the amount of accrued participation liabilities that it expects to pay during the upcoming operating cycle.
55. An entity should report cash outflows for film costs, participation costs, exploitation costs, and manufacturing costs as operating activities in the statement of cash flows, and it should include the amortization of film costs in the reconciliation of net income to net cash flows from operating activities.
56. An entity should disclose its methods of accounting for revenue, film costs, participation costs, and exploitation costs.
57. In accordance with paragraph 33 of APB Opinion 20, *Accounting Changes*, and paragraph 26 of APB Opinion 28, *Interim Financial Reporting*, an entity should disclose the effect on income before extraordinary items, net income, and related per share amounts of the current fiscal period for a change in estimate that affects several future periods.
58. An entity should disclose events occurring subsequent to the date of the balance sheet that do not require an adjustment to the financial statements but that are of such a nature that disclosure of them is required to keep the financial statements from being misleading.

Amendment to Other Guidance

59. This amends SOP 93-7. The following footnote is added to “FASB Statement No. 53” in the Appendix of SOP 93-7.

In 2000, the FASB rescinded FASB Statement No. 53 and AcSEC issued SOP 00-2, Accounting by Producers or Distributors of Films. The provisions of SOP 93-7 apply to entities within the scope of SOP 00-2.

Effective Date and Transition

60. This SOP is effective for financial statements for fiscal years beginning after December 15, 2000. Earlier application is encouraged. The cumulative effect of changes in accounting principles caused by adopting the provisions of this SOP should be included in the determination of net income in conformity with paragraph 20 of APB Opinion 20. Disclosure of pro forma effects of retroactive application (APB Opinion 20, paragraph 21) is not required. An entity should not restate previously issued annual financial statements.

The provisions of this Statement need not be applied to immaterial items.

Basis for Conclusions

Scope

61. This SOP applies to all kinds of films, including an episodic television series. However, as a result of the unique nature of an episodic television series, AcSEC decided to provide additional guidance in this area. In response to some respondents to the exposure draft of the SOP, AcSEC reorganized the SOP to clearly distinguish between the accounting requirements for all kinds of films and the additional guidance for an episodic television series. The requirements of this SOP do not apply to transactions or activities within the scope of other authoritative literature listed in paragraph 5.

The requirements of this SOP apply to films exploited by the entity directly, or licensed or sold to others. AcSEC observed that even though an entity may be considered to be primarily a film enterprise, it is still subject to generally accepted accounting principles (GAAP) besides those addressed in this SOP, for example, when involved with a transaction for the licensing of record masters, software development, and so forth.

Revenue Recognition

Basic Principles

62. The basic standard for revenue recognition is set forth in paragraph 83 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, which provides that "[revenue] recognition involves consideration of two factors, (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important consideration."
63. ***Exclusivity and Substantially All.*** Paragraph 7 of the exposure draft proposed that, in addition to the conditions in paragraph 6 of that exposure draft, a licensing arrangement should transfer substantially all of the benefits and risks incident to ownership of a film on an exclusive basis for an individual market and territory in order for an entity to account for the transaction as a sale, and thus recognize revenue immediately. AcSEC based that concept on FASB Statement No. 13, *Accounting for Leases*, as it relates to the timing of revenue recognition when distinguishing between sales-type leases and operating leases. Therefore, under paragraph 7 of the exposure draft, an entity would have recognized revenue from a nonexclusive arrangement in a manner similar to an operating lease.
64. Based on the arguments presented in the comment letters to the exposure draft, AcSEC decided that exclusivity should not be one of the conditions for revenue recognition in the film industry. AcSEC acknowledges that, under an exclusivity arrangement, the value of a film license to a customer has two major components: (a) the customer's right to use the film (in accordance with the license arrangement)

and (b) the customer's right to use the film exclusively in a particular market and territory (which thereby restricts the entity's right to license the film to other customers). Therefore, for an exclusive license arrangement, AcSEC considered requiring bifurcation of the total license fee between the two major components. Under that scenario, an entity would recognize revenue from the fees allocated to the first component in accordance with the conditions of paragraph 6 of the exposure draft and it would recognize revenue on the fees allocated to the second component ratably over the license period.

65. AcSEC rejected the bifurcation approach primarily because it believes that the approach is not operational. Also, AcSEC agrees with many of the respondents to the exposure draft who noted that the "substantially all" condition of paragraph 7 was subjective and, if kept as a revenue recognition condition, could lead to diversity in practice. AcSEC concluded that the approach proposed in the exposure draft was not operational.
66. AcSEC also acknowledges the arguments made by some respondents to the exposure draft who noted that exclusivity, even though it may be part of licensing arrangements, is becoming less meaningful as entities are exploiting films concurrently in the same territories through various marketing approaches, such as pay-per-view and home video.
67. A number of respondents to the exposure draft and AcSEC believe that if paragraph 7 of the exposure draft was maintained, AcSEC would need to more narrowly define *market* and *territory* to ensure comparability in financial reporting. Ultimately, AcSEC needed to choose between (a) attempting to provide restrictive definitions, which could lead to less desirable revenue recognition in certain circumstances, or (b) removing the requirements of paragraph 7 of the exposure draft, which would result in earlier but more consistent revenue recognition within and between entities. AcSEC believes that it cannot and should not define those terms narrowly. AcSEC believes that the definitions of market and territory should be sufficiently flexible to allow each entity to designate its markets and territories based on the way it conducts business. Accordingly, AcSEC decided not

to include the provisions of paragraph 7 of the exposure draft in this SOP.

68. ***Customer Acceptance.*** Some respondents to the exposure draft believe that customer acceptance of a film should be an explicit condition of revenue recognition. Those respondents believe that this SOP should be consistent with paragraph 20 of SOP 97-2. AcSEC appreciates the arguments of those who desire complete consistency with the revenue recognition criteria of SOP 97-2. However, because of the rapid technological changes of software, and for other reasons, AcSEC believes that the differences between licensing arrangements of software and films may be significant and could result in different conclusions on revenue recognition. SOP 97-2 addresses software arrangements under which customer acceptance is most often evidenced by physical delivery. In the film industry, physical delivery may often not occur until well after the point at which the customer's license period begins and the film is complete and available for immediate and unconditional delivery at the customer's request. Therefore, AcSEC concluded that the customer acceptance condition of this SOP should not be identical to that of SOP 97-2. AcSEC believes that the delivery conditions set out in paragraphs 11 through 14 of this SOP adequately address the issue of customer acceptance.
69. ***Sales and Licensing.*** Paragraph 7 of the SOP provides the revenue recognition conditions for a sale or licensing arrangement. Though most of the SOP provides guidance on what is commonly understood in the film industry as licensing arrangements, the conditions of paragraph 7 also apply to an entity's outright sale of its rights to a film. If the price from the sale of a film includes a variable element (as opposed to a fixed fee sale), AcSEC acknowledges that the application of the individual-film-forecast-computation method results in recognizing a gain/loss that is different than that calculated using a traditional sales model. However, AcSEC believes that by treating the accounting for an outright sale with a variable element similar to that of a license arrangement with a variable element, the SOP will help prevent diversity in practice because entities (a) will have no accounting reason to structure transactions as sales

versus licenses and (b) will not have to determine which license arrangements are in-substance sales.

Persuasive Evidence of an Arrangement

70. AcSEC understands that practice in the film industry varies regarding the use of contracts for the purpose of documenting license arrangements. Though licensing arrangements are normally documented by contracts, AcSEC understands that sales or exploitation arrangements in certain sectors of the industry are evidenced by documentation other than a contract. For example, customer orders in direct home video distribution are normally evidenced by written or on-line purchase orders. AcSEC believes that such documentation is sufficient to provide persuasive evidence of an arrangement. Accordingly, AcSEC concluded that documentation other than a contract can be sufficient evidence of an arrangement.

Delivery

71. AcSEC believes that, for most product sales and licenses, an entity should not recognize revenue until it delivers the product to the customer. Recognition of revenue on delivery is consistent with paragraphs 83(b) and 84 of FASB Concepts Statement No. 5. Paragraph 83(b) provides the following guidance for recognition of revenue.

Revenues are not recognized until earned. An entity's revenue-earning activities involve *delivering* or producing goods, rendering services, or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. [Footnote omitted][Emphasis added]

Paragraph 84 states that in recognizing revenues and gains:

The two conditions [for revenue recognition] (being realized or realizable and being earned) are usually met by the time product or merchandise is delivered...to customers, and revenues...are commonly recognized at time of sale (usually meaning *delivery*). [Emphasis added]

72. As discussed in paragraph 12 of this SOP, rather than requiring immediate or direct delivery of a film print to a customer, certain licensing arrangements in the film industry require only that an entity grant the customer immediate and unconditional access to the film. Once an entity provides access, the licensing arrangement obligates the customer to pay for the film regardless of whether the customer requests or receives the film. AcSEC believes that when an entity makes a completed film available to a customer, it “has substantially accomplished what it must do to be entitled to the benefits represented by the revenues” (as required by paragraph 83(b) of FASB Concepts Statement No. 5). In such arrangements, not physically delivering the film (often as a result of a customer not requesting the film even though the license period has begun) is not a factor sufficient to preclude revenue recognition. Therefore, AcSEC believes that an entity has complied with the delivery requirements of this SOP when the entity makes the film available to the customer and meets the other conditions of paragraph 7. Further, AcSEC believes that if the film is at a film laboratory, providing the customer with unconditional and immediate access to the film is a prerequisite for revenue recognition. If an arrangement is silent as to delivery, AcSEC concluded that physical delivery is an inherent requirement of revenue recognition.
73. Many licensing arrangements require an entity to make changes to a film after it makes the film available to a customer. AcSEC considered the question of when changes that are required after a film’s initial availability should preclude an entity from recognizing revenue on a film. AcSEC understands that an entity will make the changes often at a time requested by the customer, which may or may not be immediately after a film is initially available to the customer. The exposure draft stated, and AcSEC continues to believe, that an obligation to make significant changes to a film after its initial availability to a customer precludes the entity from recognizing revenue on the film until the entity completes those significant changes (and it meets the other conditions of paragraph 7).
74. Based on comment letters received on the exposure draft, AcSEC clarified its definition of significant changes to a film

after its initial availability to a customer. AcSEC believes that changes to a film are significant if they are additive; that is, they require the creation of additional content. Changes, such as dubbing and subtitling, are made to existing content and, therefore, they are not significant.

75. AcSEC believes that an obligation to make insignificant changes to a film after its initial availability to a customer should not preclude revenue recognition if an entity meets all other conditions of paragraph 7 of this SOP. AcSEC believes that an obligation to make insignificant changes does not affect an entity's having substantially accomplished what it must do to earn revenue. AcSEC believes that SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, supports AcSEC's position. Paragraph 30 of SOP 81-1 states, "Under the completed-contract method, income is recognized only when a contract is completed or substantially completed." Paragraph 52 of SOP 81-1 states, "As a general rule, a contract may be regarded as substantially completed if remaining costs and potential risks are insignificant in amount. The overriding objectives are to maintain consistency in determining when contracts are substantially completed and to avoid arbitrary acceleration or deferral of income."

Availability

76. As discussed in paragraph 14, in certain situations, an entity may prohibit a customer from beginning its initial exploitation, exhibition, or sale of a film. One of the more common prohibitions is a "street date" restriction used in connection with the sales or rentals of videocassettes. This occurs when an entity ships videocassettes to a customer on a certain date, but restricts sales prior to the "street date." Because the customer does not have the ability to exploit, exhibit, or sell the film in such situations, the conditions of paragraph 7(c) are not met. Consequently, an entity should not recognize revenue until the restriction lapses. This initial-use prohibition does not apply to contractual restrictions after the period of exploitation, exhibition, or availability for sale of a film begins (for example, a licensing arrangement that allows a customer to air a film only once per year over the license period).

Fixed or Determinable Fee

77. Paragraph 83 of FASB Concepts Statement No. 5 reads, in part, “Further guidance for recognition of revenues and gains is intended to provide an acceptable level of assurance of the existence and amounts of revenue and gains before they are recognized.” AcSEC believes that “an acceptable level of assurance” of the amount is attained when the amount of the arrangement fee is fixed or determinable and the other conditions of paragraph 7 are met. If the arrangement fee is based on a percentage of a customer’s revenue, the fee does not become fixed or determinable until the customer’s revenue is earned. Because the customer’s revenue is not earned until the exhibition or other exploitation of the film, AcSEC concluded that a fee that is based on a percentage of the customer’s revenue from a film should not be recognized until the customer’s exhibition or other exploitation of the film.

78. **Flat Fees.** In paragraph 16 of this SOP, AcSEC concluded that, if a licensing arrangement provides for a flat fee with respect to multiple films, markets, or territories, an entity should allocate the fee to the individual films based on the relative fair value(s) of the rights to exploit the film(s) in the respective markets and territories. AcSEC believes that basing the allocation on relative fair value is consistent with the accounting for multiple element transactions in other industries. For example, paragraph 12 of FASB Statement No. 45, *Accounting for Franchise Fee Revenue*, states the following.

The franchise agreement ordinarily establishes a single initial franchise fee as consideration for the franchise rights and the initial services to be performed by the franchisor. Sometimes, however, the fee also may cover tangible property, such as signs, equipment, inventory, and land and building. In those circumstances, the portion of the fee applicable to the tangible assets shall be based on the fair value of the assets.

79. The exposure draft stated that an entity should base the allocation on an *entity-specific* and *product-specific* estimate of relative fair values. AcSEC decided to drop that language because those terms do not provide substantive additional guidance on determining fair value. AcSEC be-

lieves that the requirement of allocations based on relative fair values is adequate.

80. **Variable Fees.** If a licensing arrangement bases an entity's arrangement fee on a percentage or share of a customer's revenue, the entity's fee does not become fixed or determinable until the customer exhibits or exploits the film. Because the customer's revenue is not earned until the exhibition or other exploitation of the film, AcSEC concluded an entity should not recognize revenue that is based on a percentage or share of the customer's revenue from a film until the customer's exhibition or other exploitation of the film (and the entity meets the other conditions of paragraph 7 of this SOP).
81. **Nonrefundable Minimum Guarantees (Not Cross-Collateralized).** The exposure draft proposed that an entity should account for licensing arrangements with guaranteed nonrefundable minimum amounts payable against variable fees covering single films or covering multiple films in which the films are not cross-collateralized in a manner similar to how it should account for flat fees. Under that guidance, an entity would have recognized revenue when it met the conditions in both paragraphs 6 and 7 of the exposure draft. AcSEC was concerned about allowing an entity to recognize revenue immediately if, in fact, the entity may have been doing nothing more than financing against future revenue. However, the proposed requirements for revenue recognition in paragraph 7 of the exposure draft alleviated AcSEC's concern. Because AcSEC decided to delete paragraph 7 of the exposure draft in this final SOP, AcSEC believed that it was necessary to revisit the accounting for nonrefundable minimum guarantees.
82. In its deliberations, AcSEC concluded that an entity should recognize a nonrefundable minimum guarantee fee against a variable fee covering a single film or covering multiple films that are not cross-collateralized as revenue immediately when the entity meets all of the conditions of paragraph 7. AcSEC believes that the conditions of paragraph 7 provide an appropriate model for determining whether an entity should recognize revenue for a nonrefundable minimum guarantee fee. AcSEC believes that such fees are sim-

ilar to flat fees and flat fees with upside revenue potential, and that an entity should account for each kind of fixed fees similarly.

83. In its deliberations, AcSEC was concerned about an entity recognizing revenue for a variable fee arrangement based on whether it could or could not secure a nonrefundable minimum guarantee fee. Consequently, AcSEC considered whether the SOP should require that an entity recognize all nonrefundable minimum guarantee fees as revenue ratably over the license period.
84. If it had required ratable revenue recognition for nonrefundable minimum guarantee fees in arrangements that are not cross-collateralized, AcSEC believes that such a requirement would conflict with how AcSEC views flat fees because the economics of flat or fixed fees and nonrefundable minimum guarantee fees (on a film or films that are not cross-collateralized) are substantially similar. Therefore, AcSEC would have had to reconsider the accounting model for flat fees (and thus the revenue recognition conditions of paragraph 7). AcSEC believes that this reconsideration was not necessary.
85. AcSEC understands that entities often cannot, in substance, determine the differences between a licensing arrangement with a flat fee plus a variable element (and thus the variable portion is an equity kicker) or a nonrefundable minimum guarantee fee against the variable fee. In fact, there is little, if any, economic difference in those two kinds of arrangements. If the SOP had required an entity to recognize all nonrefundable minimum guarantee fees ratably, AcSEC believes that entities could easily structure arrangements such that the nonvariable element would instead be a flat fee and recognize the flat fee as revenue immediately (if all of the other conditions of paragraph 7 were met).
86. In reaching its conclusions on accounting for revenue related to fixed fees or nonrefundable minimum guarantees on a film or films that are not cross-collateralized, AcSEC considered various methods, including applying the guidance applicable to minimum guarantees in FASB Statement No. 50.

87. In FASB Statement No. 50, a conclusion was reached that licensors should report minimum guarantees as liabilities and recognize revenue as the license fee is earned. AcSEC has been informed that there are differences between minimum guarantees in the film industry and minimum guarantees in the music industry. Minimum guarantees in the music industry generally relate to the rights to distribute the music product of an artist or artists for a specific period of time. Much of this product may not exist at the time the minimum guarantee arrangement is entered into. Minimum guarantees in the film industry may actually represent a sale of rights to exhibit a film in a particular market and territory during the film's useful life in that market and territory with a potential share in the results above some defined amount. These arrangements are used in connection with customers in lieu of actual results reported by the customer, which may be untimely, unreliable, or both. Because of the differences between the industries in the nature of the minimum guarantees and in the circumstances under which they are used, AcSEC concluded that the guidance in FASB Statement No. 50 should not be applied to minimum guarantees in the film industry.
88. ***Nonrefundable Minimum Guarantees (Cross-Collateralized)***. AcSEC believes that the accounting for a nonrefundable minimum guarantee fee on a group of films that are cross-collateralized should be different than that for such a fee on a group of films that are not cross-collateralized. In a cross-collateralized arrangement, the fee paid by a customer is dependent on the performance of *all* of the films in the arrangement. Therefore, the fees are not fixed or determinable with respect to each film in the arrangement until the customer exhibits or exploits all of the films, and an entity should not immediately recognize the entire nonrefundable minimum guarantee fee as revenue because it cannot determine which film will earn revenue until exploitation occurs.
89. AcSEC concluded that an excess of a nonrefundable minimum guarantee fee over the variable fee recognized in a cross-collateralized arrangement should be recognized as revenue at the end of the license period. AcSEC believes

that such an excess is not earned until the period expires, and therefore, it should not be recognized as revenue until the arrangement period ends.

Collectibility

90. AcSEC concluded that collectibility must be reasonably assured before an entity may recognize revenue. This conclusion is based on paragraph 1 of Chapter 1A of ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*, which states the following.

Profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured.

Licensing of Film-Related Products

91. AcSEC understands that in many arrangements, the release of a film is a requirement in order for the entity to be entitled to fees from its licensing of film-related products. Even if the release of a film is not a legal requirement in order for the entity to be entitled to such fees, AcSEC believes that, because of customer expectations, the entity has an implicit obligation to release the film in order to be entitled to the fees. Therefore, AcSEC concluded that an entity should not recognize revenue on such licensing arrangements until it releases the film. Because fees from licensing of film-related products usually varies directly with the success of a film, the film industry includes such fees in ultimate revenue.

Distribution Arrangements

92. Some respondents to the exposure draft requested that the SOP address an entity's accounting for co-production and co-financing arrangements with other entities that are beyond "standard" distribution arrangements. Such arrangements are becoming prevalent in the film industry as entities look to share the risks (and thus the rewards) of producing and distributing films. AcSEC believes that such arrangements are not unique to the film industry (for example, real estate, construction, and pharmaceutical industries use co-production and co-financing arrangements), and,

therefore, they are beyond the scope of this SOP. AcSEC also believes that the accounting for co-production and co-financing arrangements is based on facts, circumstances, and contractual agreements. For example, a shared arrangement could be any of the following:

- a. A joint venture subject to joint venture accounting
- b. An arrangement that requires one entity to consolidate another entity in its financial statements
- c. A financing arrangement
- d. An arrangement that is not a sale of a copyright but rather a sale of future revenue subject to the accounting requirements of EITF Issue No. 88-18, “Sale of Future Revenues”

This is not to say that an entity has a choice of these methods. The determination of the appropriate method is based on the specific facts and circumstances involved.

Costs and Expenses

Film Costs—Capitalization

93. In paragraph 32 of this SOP, AcSEC concluded that, if a property under development has not been set for production within three years from the first capitalized transaction related to that property, it is presumed that the property will be disposed of. AcSEC acknowledges that (a) three years is arbitrary but decided to retain that aspect of current practice and (b) set for production is an intentionally chosen high hurdle to evidence use of a property. AcSEC also concluded that when an entity determines that such property will be disposed of at a loss, that loss should be recognized by a charge to the income statement. AcSEC considered retaining the provision of paragraph 17 of FASB Statement No. 53, wherein the cost of a property not used in production of a film, after being held for three years, be charged to production overhead. AcSEC concluded that this would result in amortizing overhead costs that were neither directly nor indirectly related to a film, and therefore, AcSEC rejected that approach. Additionally, AcSEC decided that in measuring impairment for capitalized costs

of property not set for production within three years of the first capitalized transaction, the rebuttable presumption should be that the property will be disposed of by abandonment (not used) and as such has a fair value of zero. AcSEC concluded that an entity could overcome this presumption only if management, having the authority to approve the action, had committed to a plan to sell such property. AcSEC believes this provision will minimize the risk of reporting, for long periods, capitalized costs that do not have discernible future benefits and enhance comparability within the industry.

Film Costs—Capitalization (Episodic Television Series)

94. AcSEC concluded that, for an episodic television series that has not yet met the conditions for including secondary market revenue in ultimate revenue, film costs for each episode in excess of contracted for revenue should be expensed immediately. AcSEC understands that entities produce a series knowing that the series will lose money in the early years. Although the success rate of producing a successful series is relatively low, entities are willing to incur such losses because some percentage of episodic television series will become successful and generate significant profits.
95. What an entity is trying to develop is an episodic television series that will generate revenue from secondary markets. In order for it to become feasible to obtain secondary market revenue from a television series, an entity must produce a minimum number of episodes. Because many contracts between an entity and the initial exhibitor (for example, a network) result in the entity receiving less in fees than the costs necessary to develop the series, AcSEC views the arrangement as a partially funded research and development effort to “create” a series that will gain public acceptance.
96. However, given the uncertainty of the potential for secondary markets in the early years of a series, AcSEC believes that it is inappropriate for an entity to report, as an asset, film costs for each episode in excess of revenue contracted for that episode. AcSEC believes that this uncertainty exists until an entity meets the conditions of paragraph 39(b).

97. AcSEC considered and rejected requiring entities to recognize the total loss expected for the number of episodes that the entity expects to deliver under a contract. AcSEC considered paragraph 8 of FASB Statement No. 5, which requires accrual of a loss contingency if (a) information available prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements, and (b) the amount of the loss can be reasonably estimated. AcSEC understands that, although the terms of contractual arrangements between a television network and an entity in the film industry for delivery of an episodic television series may be binding and noncancellable in form, in practice these contracts often are amended or canceled in the initial years of the series. If a series does not achieve ratings success quickly, the network may wish to cancel the series notwithstanding previously established contractual arrangements. Also, because producers normally incur losses while producing episodes in the early years, it is often in their best interests to cancel a series if secondary market exhibition or exploitation is unlikely. As a result of the discussion in this and preceding paragraphs, AcSEC believes that for a new series in development, notwithstanding a contract, the probability criterion of FASB Statement No. 5 has not been met. More important, given its views in paragraph 95 that the development of a series is akin to a partially funded research and development effort, AcSEC concluded that FASB Statement No. 5 accrual criteria and disclosures are not applicable.
98. Once the criteria for considering secondary market revenue are met and the secondary market revenue is included in ultimate revenue, AcSEC believes that an entity should capitalize all film costs for an episodic product (without regard to initial market revenue limitations on each episode). AcSEC believes that when an entity is in this situation, the uncertainties surrounding whether a series will be successful are sufficiently minimized and, therefore, the probability of the recoverability of any additional film costs above contracted-for-revenue is high enough such that an entity should not immediately expense costs in excess of contracted-for-revenue.

Film Costs Amortization

99. AcSEC continues to believe that the individual-film-forecast-computation method is the most appropriate method for expensing film costs in the film industry. AcSEC believes that this method best associates the costs of film production with the related revenue earned.

Participation Cost Accruals

100. The accounting for participation and residual costs (referred to collectively as participation costs) was a complex issue for AcSEC. AcSEC considered various approaches to accounting for these costs.
101. **One Event Creates Obligation.** The exposure draft proposed that an entity accrue total expected participation costs and report those amounts as film costs and related participation liabilities. That approach was based on AcSEC's belief that participation costs are a form of deferred compensation for individuals who provide services in the production of a film. Deferred compensation ordinarily is accrued in the periods when the recipients provide services. In this view, the generation of revenue is the confirming event that fixes the estimated amount payable, similar to a defined contribution plan that calls for contributions for periods after an individual retires or terminates. In addition, AcSEC concluded in the exposure draft that the proposed accounting for participation costs is consistent with FASB Statement No. 5, because the services provided by the participants under contract represent a past event that gives rise to a liability.
102. **Two Events Create Obligation.** AcSEC also considered the views of those who believe that two events are needed to recognize a participation liability: (a) the participants' performance, and (b) the film earning the minimum cumulative revenue or profit required to trigger payments to participants. Proponents of this viewpoint believe that, even though the participants' performance has already occurred as the film was created, no participation liabilities will become due unless the film earns the minimum cumulative revenue or profit.

103. ***Current Practice.*** Further, based on comments made by respondents to the exposure draft, AcSEC considered arguments suggesting that the SOP should maintain current practice, which is similar to how entities in other industries report royalty fees on licensed products. Those comment letters indicated that entities in other industries do not accrue liabilities for the total expected royalty fees they will pay on the products they license, even though they may have completed all of the manufacturing efforts and the total amount to be paid is reliably measurable. Rather, those entities record the royalty expense as a cost of the sale or license as they earn revenue on the products to which the royalties relate. This is a form of the two events liability recognition approach with the second event being earning the revenue from sales of products.
104. AcSEC believes that the arguments supporting all three approaches have merit and can be supported by analogies to authoritative literature. Deciding the appropriateness of the one versus two event approaches would have had implications beyond the scope of this SOP and, therefore, AcSEC decided to maintain current practice in accounting for participation costs. Current practice requires that, during the ultimates period, an entity should accrue and expense participation costs in each reporting period by multiplying unaccrued (that is, not yet expensed) ultimate participation costs by the ratio of current period actual revenue to estimated remaining unrecognized ultimate revenue as of the beginning of the current fiscal year. The requirement to limit the period of ultimate participation costs to that for ultimate revenue maintains consistency within the SOP. Although the reported liability at any given time differs under the three approaches, AcSEC notes that the income statement results under current practice are not significantly different from the results under the approach proposed in the exposure draft.
105. AcSEC was also informed that certain users of film entities' financial statements prefer the accrued participation liability under current practice compared to that under the approach prescribed by the exposure draft. Those users indicated that they would factor participation costs assets out of their

analyses. AcSEC found this helpful in arriving at its conclusion, as discussed in the previous paragraph.

106. AcSEC understands that a participation arrangement may require an actor to help promote the release of a film in a particular market or territory. AcSEC believes that such an activity and related costs relate to the exploitation of a film. AcSEC considered and rejected requiring an entity to identify and separate the portion of costs in a participation arrangement that relates to exploitation activities. AcSEC believes that such a requirement is not practicable because overall participation costs are typically not broken down by the specific efforts required of the actor in a participation arrangement. In addition, AcSEC believes that the benefits of separating the costs of the exploitation efforts are minimal.

Changes in Estimates

107. The exposure draft proposed that an entity account for the effects of changes in estimates of revenue and costs prospectively, starting with the beginning of the period of change. FASB Statement No. 53 required that an entity account for the effects of changes in estimates prospectively, starting with the beginning of the fiscal year of change. Many respondents to the exposure draft favored the FASB Statement No. 53 approach for changes in estimates. They believe (and AcSEC concurs) that the exposure draft's approach would have encouraged entities to make aggressive estimates of ultimate revenue because revised estimates would be accounted for prospectively from the period of change.
108. This SOP effectively maintains the approach required by FASB Statement No. 53. AcSEC believes that the film industry and users of financial statements find that this approach serves their needs, and AcSEC did not have a compelling reason to change current practice.
109. AcSEC considered requiring a cumulative effect catch-up adjustment through the income statement, which would have required an entity to go back beyond the fiscal year of change. However, AcSEC rejected this approach primarily because of the expected difficulties of implementing this requirement, for example, the need to track impairment write-

downs on a film-by-film basis and adjust previous estimates for those write-downs.

110. The one exception to the changes in estimate guidance is when the recognized participation costs liability exceeds the estimated unpaid ultimate participation costs for an individual film. Because the individual-film-forecast-computation method does not provide a mechanism to reduce recognized liabilities in such situations, paragraph 41 requires a reduction in the reported participation liability and unamortized film costs under such circumstances. Because of the interaction of this calculation with the amortization of film costs calculation (which is based on estimates), AcSEC concluded that the offset to the reduction in the liability should be first used to reduce unamortized film costs before impacting an entity's income statement.

Ultimate Revenue

111. In paragraphs 38 and 39 of this SOP, AcSEC reached conclusions that limit the amount of revenue that an entity should include in ultimate revenue. AcSEC concluded that estimated ultimate revenue should include only those revenues that are expected to be recognized within a limited period. In addition, AcSEC concluded that entities should not include certain forms of more speculative revenue in ultimate revenue. AcSEC believes that the guidance in this SOP will help promote comparability among entities within the industry.
112. AcSEC acknowledges that the ten-year provision is arbitrary and that many films have lives that extend beyond ten years. AcSEC is concerned, however, about diversity that has arisen in the industry with respect to the estimation of ultimate revenue. AcSEC concluded that such a limitation is needed to provide greater comparability within the industry. AcSEC also notes that, in most instances, the significant majority of a film's revenue will have been earned within the ten-year period.
113. One exception to the ten-year provision is for a successful episodic television series that has been in production for at least five years. In these instances, AcSEC decided that en-

tities should include in ultimate revenue all revenue expected to be recognized through five years from the date of delivery of the most recent episode.

114. Another exception to the ten-year provision is for acquisitions of previously released films as part of a film library. In many such acquisitions, the ultimate revenue used to assign acquisition cost or value to the films will be generated over periods exceeding ten years. AcSEC believes that in such situations, the same revenue used to value the acquired films should be used to apply the individual-film-forecast-computation method. However, to address concerns similar to those discussed in paragraph 112, AcSEC concluded that it should place a limitation on the revenue that an entity should include in the determination of ultimate revenue. AcSEC has been informed that in applying APB Opinion 16, *Business Combinations*, in the film industry, twenty years is the life most often assigned to a film library.
115. AcSEC believes that an amortization period longer than ten years for films in a library is appropriate because of the differences between such films and new films exploited individually. In almost all cases, a new film that is exploited individually will earn the vast majority of its revenue within the first few years, followed by a relatively long stream of lower, more level revenue over the remainder of its life. However, a film that is included in a film library has experienced its initial cycle in all markets and, therefore, has entered into the period of more stable, lower level revenue. AcSEC's decision that a film must have had an initial release date at least three years prior to the acquisition date to be included in a film library is arbitrary, but AcSEC believes that its decision will help ensure comparability in practice.
116. Paragraph 29(d) of the exposure draft proposed that ultimate revenue should exclude all revenue from the manufacture and sale of peripheral items. However, AcSEC decided that the limitations on ultimate revenue should be the same for both sales of peripheral items and licensing arrangements with third parties for peripheral items. Therefore, this SOP requires that an entity include in ultimate revenue the portion of the estimated revenue from the sale of peripheral

items that is attributable to the exhibition or exploitation of a particular film.

Film Costs Valuation

117. In the exposure draft and in this SOP, AcSEC concluded that, for impairment purposes, a long-lived asset model is more consistent with the manner in which an entity will exploit a film than is an inventory model. Revenue may be earned from a film over a long period. Additionally, a film is sold or licensed repeatedly by an entity in different markets and territories (unlike inventory, which is sold once). Therefore, AcSEC concluded that an entity should use the fair value of a film when measuring impairment.
118. AcSEC decided that an entity's measurement of impairment of a particular film should be triggered by events or circumstances that indicate that the fair value of a film may be less than its carrying amount. AcSEC believes that an entity rarely would get to the step of measuring impairment of a film if the trigger (that is, recognition test) was a comparison of estimated future cash flows (undiscounted and without interest charges) to unamortized film costs. As a result, AcSEC concluded that the approach in this SOP is preferable.
119. In determining the fair value of a film, AcSEC observed that the underlying premise of the individual-film-forecast-computation method is an entity's ability to reliably estimate future revenues. Therefore, AcSEC observed that the estimates of the most likely future cash inflows used in determining the fair value of a film would include those estimates used in the determination of a film's ultimate revenue in addition to other amounts, as discussed in paragraph 45.
120. Many respondents to the exposure draft believe that films should not follow a long-lived asset model. They believe that the majority of film costs are amortized within the first few years of a film's life.
121. Respondents favoring an alternative model believe that a film entity is in business to produce and license films, and that, films "are held for sale in the ordinary course of business," as discussed in paragraph 2 of chapter 4 of Account-

ing Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins*.

122. AcSEC believes that the arguments for both models have merit. AcSEC is less concerned with choosing an asset model for films than it is with ensuring that users of financial statements receive relevant information. AcSEC believes that users want and need film entities to report (a) the portion of film costs that will be amortized in the next operating cycle and (b) film costs, participation costs, exploitation costs, and manufacturing costs as cash flows from operating activities rather than from investing activities. Accordingly, this SOP requires entities to report the information that AcSEC believes users need. AcSEC also believes that the required treatment of cash flows is consistent with paragraphs 86 and 87 of FASB Statement No. 95, *Statement of Cash Flows*.

Exploitation Costs

123. In the exposure draft, AcSEC noted that the film industry's pattern of incurring exploitation costs differs significantly from the pattern in other industries. A high proportion (perhaps as much as 80 percent) of the total lifetime exploitation costs incurred by an entity with respect to a film is incurred in connection with the release of a film into domestic and international theatrical markets. An entity will incur the most significant amount of expenditures on or before the first weekend to "open" the film domestically.
124. The exposure draft discussed many different accounting alternatives for exploitation costs and presented AcSEC's original position on each alternative. Those arguments are not restated in this SOP; rather, this basis for conclusions addresses why AcSEC ultimately decided that an entity should account for exploitation costs in accordance with the provisions of SOP 93-7 and why AcSEC changed its position from the exposure draft (which was that only initial theatrical exploitation costs would be capitalized and amortized over a period not to exceed three months; all other exploitation costs would be expensed as incurred).
125. When SOP 93-7 was issued, film entities were excluded from its scope because the SOP could not change the pro-

visions in FASB Statement No. 53 (which falls into level a in the hierarchy of GAAP, as discussed in Statement on Auditing Standards (SAS) No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*). However, because the FASB will rescind FASB Statement No. 53 upon the effective date of this SOP, AcSEC was able to debate whether SOP 93-7 should apply to films.

126. The accounting for exploitation costs was a difficult issue for AcSEC. AcSEC believes that the accounting proposed in the exposure draft has merit. However, AcSEC's position in the exposure draft was a compromise between parties that preferred (a) capitalization and amortization of exploitation costs for all markets and territories, (b) amortization periods longer than three months, (c) capitalization and expensing at first showing of a film, or (d) inclusion of film entities in the scope of SOP 93-7.
127. Based on its review of the comment letters, AcSEC took a fresh look at its position in the exposure draft. Some respondents, including a number of producers of films, stated that the SOP should require that entities expense exploitation costs in accordance with SOP 93-7. Many supporters of the position in the exposure draft acknowledged that this solution is not well supported by existing authoritative accounting literature. AcSEC believes that SOP 93-7 is the most definitive guidance for exploitation costs. AcSEC ultimately could not rationalize why an entity should account for such costs incurred in the film industry differently from how entities account for the same costs incurred in other industries. AcSEC concluded that the guidance in this SOP should be similar to how other industries account for similar costs. For a further discussion on the rationale for the accounting requirements in SOP 93-7, entities may review the basis for conclusions in that SOP.

Presentation and Disclosure

128. Paragraph 51 requires disclosure of the portion of the costs of completed films that are expected to be amortized during the upcoming operating cycle. This required disclosure responds to the needs of users of financial information.

129. AcSEC believes that most entities will have an operating cycle of twelve months. However, AcSEC also believes that certain entities in the film industry may produce a small number of films and that the production period for those entities may exceed twelve months. Therefore, in accordance with paragraph 5 of Chapter 3A of ARB No. 43, AcSEC concluded that entities should be allowed to designate an operating cycle of greater than twelve months when facts and circumstances justify a longer period.
130. Public companies are required to disclose in their annual filings with the U.S. Securities and Exchange Commission (SEC) the balances of unamortized capitalized film costs, excluding film libraries, whose amortization within three years of the reporting date would not consume 60 percent of the unamortized capitalized film costs and the estimated time period to achieve 60-percent accumulated amortization. Users of financial statements have indicated that this is useful information, but given changes in the film industry and the requirement to apply SOP 93-7 to exploitation costs, an 80-percent threshold provides more relevant information. AcSEC agreed and decided to require this disclosure for all entities.
131. AcSEC decided to require disclosures of methods of accounting to ensure that the SOP is consistent with paragraph 12(b) of APB Opinion 22, *Disclosure of Accounting Policies*, which requires disclosure of “Principles and methods peculiar to the industry in which the reporting entity operates, even if such principles and methods are predominately followed in that industry.”

Effective Date and Transition

132. AcSEC believes that the advantages of retroactive application in prior periods of the provisions of this SOP would not outweigh the disadvantages. Accordingly, AcSEC concluded that the cumulative effect of changes caused by adopting the provisions of this SOP should be included in the determination of net income. In addition, AcSEC extended the effective date of the SOP by one year from the date proposed in the exposure draft to give entities more time to comply with the provisions of the SOP.

APPENDIX

Examples

EXAMPLE 1
**Revenue Recognition for a Fixed Fee,
Single Film License Arrangement**
(In Accordance With Paragraphs 15 and 27)

An entity grants to a customer a license for cable television broadcast rights for a single film. Assumptions are the following:

- a. End of entity's fiscal year is December 31.
- b. Contract execution date is July 31, 2000.
- c. License period is January 1, 2001 to December 31, 2003.
- d. The entity has met all of the revenue recognition conditions of paragraph 7 at January 1, 2001.
- e. License fee is \$19,000.
- f. Payment schedule is \$1,000 at contract execution date, \$6,000 on each of January 1, 2001, 2002, and 2003. Payments are non-interest bearing.
- g. Appropriate interest rate for computation of interest is 12 percent per year.

Income recognition is computed as follows:

| | Revenue | Interest Income |
|-----------|-----------------------|----------------------|
| Year 2000 | \$ - | \$ - |
| Year 2001 | 17,140 ⁽¹⁾ | 1,217 ⁽²⁾ |
| Year 2002 | - | 643 ⁽³⁾ |
| Year 2003 | - | - |
| | <u>\$17,140</u> | <u>\$ 1,860</u> |

(1) Sum of \$1,000 paid on contract execution, \$6,000 paid on January 1, 2001, plus the present value at 12 percent of the \$6,000 payments due on January 1, 2002 and 2003.

(2) Interest at 12 percent for twelve months on a receivable (present valued) of \$10,140.

(3) Interest at 12 percent for twelve months on a receivable (present valued) of \$5,357.

EXAMPLE 2
Allocation of Revenue for a Fixed Fee,
Multiple Film Arrangement
(In Accordance With Paragraph 16)

Assumptions are the following:

- a.* An entity grants to a customer the cable television broadcast rights to three films under a single licensing arrangement in a particular market and territory. The arrangement calls for a fixed license fee of \$30,000. The arrangement provides for a pro-rata reduction in the license fee if Film 3 is not completed and made available for delivery.
- b.* At the date of the arrangement, Films 1 and 2 are complete; Film 3 is yet to be produced. An evaluation of the relative fair values of the licensed rights to Films 1 and 2 indicate that Film 1 should be assigned 55 percent of the fixed license fee and Film 2 should be assigned 45 percent of the fee. The amount potentially refundable if Film 3 is not completed and delivered is \$10,000.

The entity should allocate the license fee as follows:

- Film 1 = \$11,000 (\$30,000 license fee, less \$10,000 potentially refundable for one incomplete film, multiplied by 55 percent)
- Film 2 = \$9,000 (\$30,000 license fee, less \$10,000 potentially refundable for one incomplete film, multiplied by 45 percent)
- Film 3 = \$10,000 (the refundable amount due if the film is not completed and made available for delivery)
-

The entity should recognize revenue on amounts allocated to each film in accordance with the provisions of this Statement of Position (SOP). If payments under such an arrangement are due in installments, applicable present value calculations should be performed, as illustrated in Example 1.

EXAMPLE 3
Revenue Recognition for a Variable Fee,
Single Film Arrangement
With a Nonrefundable Minimum Guarantee
(In Accordance With Paragraph 19)

Assumptions are the following:

- a. An entity licenses to a customer the home video rights to one film for a period of two years. The licensing arrangement provides for a variable fee to the entity equal to 30 percent of the customer's gross receipts from the exploitation of this film during the license period. The licensing arrangement also requires the customer to pay the entity a \$50,000 nonrefundable minimum guarantee against the variable fee.
- b. For purposes of this example, assume that the customer generates gross receipts from the exploitation of the film equal to \$100,000 in Year 1 and \$80,000 in Year 2. Also, assume that the entity has met all other revenue recognition conditions of this SOP.

The entity should recognize revenue as follows:

| | Nonrefundable Minimum Guarantee | Variable License Fee |
|--------|------------------------------------|-------------------------|
| Year 1 | \$50,000 ⁽¹⁾ | \$ — ⁽²⁾ |
| Year 2 | — | 4,000 ⁽³⁾ |

(1) Amount is equal to the nonrefundable minimum guarantee

(2) No variable fee is recognizable in Year 1, as the variable fee (\$100,000 gross receipts * 30 percent = \$30,000) is less than the nonrefundable minimum guarantee.

(3) The cumulative variable fee is \$54,000 [(\$100,000 + \$80,000) * 30 percent], which exceeds the previously recognized nonrefundable minimum guarantee by \$4,000. Accordingly, revenue for Year 2 is \$4,000.

EXAMPLE 4
Revenue Recognition for a Variable Fee,
Multiple Film Arrangement
With a Nonrefundable Minimum Guarantee
(In Accordance With Paragraph 20)

Assumptions are the following:

- a. An entity licenses to a customer the home video rights to five films for a period of three years. The licensing arrangement provides for a variable fee to the entity equal to 30 percent of the customer's gross receipts from the exploitation of the films during the license period. The licensing arrangement also requires the customer to pay the entity a \$50,000 nonrefundable minimum guarantee against the variable fees for the five films. The variable fees are cross-collateralized for purposes of determining any amounts due in excess of the \$50,000 nonrefundable minimum guarantee.
- b. For purposes of this example, assume the customer generates revenue as follows:

| | Film 1 | Film 2 | Film 3 | Film 4 | Film 5 | Total |
|--------|------------------|------------------|------------------|------------------|------------------|------------------|
| Year 1 | \$ 30,000 | \$ 20,000 | \$ 10,000 | \$ - | \$ - | \$ 60,000 |
| Year 2 | 10,000 | 10,000 | 5,000 | 10,000 | 5,000 | 40,000 |
| Year 3 | 10,000 | 10,000 | 5,000 | 10,000 | 5,000 | 40,000 |
| Total | <u>\$ 50,000</u> | <u>\$ 40,000</u> | <u>\$ 20,000</u> | <u>\$ 20,000</u> | <u>\$ 10,000</u> | <u>\$140,000</u> |

In this example, the entity cannot recognize the nonrefundable minimum guarantee as revenue upon the inception of the license period due to the cross-collateralization provisions of the arrangement. Instead, the entity should recognize revenue on a variable fee basis. The entity should recognize revenue as follows:

| | Film 1 | Film 2 | Film 3 | Film 4 | Film 5 | Total |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Year 1 ⁽¹⁾ | \$ 9,000 | \$ 6,000 | \$ 3,000 | \$ - | \$ - | \$18,000 |
| Year 2 ⁽¹⁾ | 3,000 | 3,000 | 1,500 | 3,000 | 1,500 | 12,000 |
| Year 3 ⁽¹⁾ | 3,000 | 3,000 | 1,500 | 3,000 | 1,500 | 12,000 |
| Subtotal | \$15,000 | \$12,000 | \$ 6,000 | \$ 6,000 | \$ 3,000 | \$42,000 |
| Year 3, at end of license period ⁽²⁾ | 2,857 | 2,286 | 1,143 | 1,143 | 571 | 8,000 |
| Total | <u>\$17,857</u> | <u>\$14,286</u> | <u>\$ 7,143</u> | <u>\$ 7,143</u> | <u>\$ 3,571</u> | <u>\$50,000</u> |

(1) Amounts are computed using 30 percent of the customer's gross receipts for the applicable films and periods.

(2) The cumulative amount of the entity's variable fees earned is less than the nonrefundable minimum guarantee. The excess (\$8,000) of the nonrefundable minimum guarantee over cumulative earned revenue is recognized at the end of the license period, and is allocated to the individual films based on their relative cumulative variable fees.

EXAMPLE 5
Illustration of the Individual-Film-Forecast
Method of Amortization,
for a Film in Its Initial Year of Release
(In Accordance With Paragraph 34)

Assumptions are the following:

- a. Film cost—\$50,000
- b. Estimated ultimate revenue—\$100,000
- c. Actual revenue earned in Year 1—\$60,000
- d. Estimated ultimate participation costs—\$10,000

Film Cost amortization in Year 1:

$$\frac{\$60,000 \text{ earned revenue}}{\$100,000 \text{ ultimate revenue}} * \$50,000 \text{ film cost} = \underline{\underline{\$30,000}}$$

Participation costs accrued in Year 1:

$$\frac{\$60,000 \text{ earned revenue}}{\$100,000 \text{ ultimate revenue}} * \$10,000 \text{ ultimate participation costs} = \underline{\underline{\$6,000}}$$

EXAMPLE 6
Illustration of the Individual-Film-Forecast
Method of Amortization, for a Film Where Estimates
Are Revised Subsequent to the Initial Year of Release
(In Accordance With Paragraph 36)

Assumptions are the following:

- a. Film cost is \$50,000
- b. Estimated ultimate revenue:
 - Year 1—\$100,000
 - Year 2—\$90,000 (Note: not the remaining ultimate revenue starting from this year)
- c. Actual revenue earned:
 - In Year 1—\$60,000
 - In Year 2—\$10,000
- d. Estimated ultimate participation costs:
 - Year 1—\$10,000
 - Year 2—\$9,000 (Note: not the remaining ultimate participation costs starting from this year)
- e. For Year 1, film cost amortization was \$30,000 and participation costs accrued were \$6,000.

Film Cost amortization in Year 2:

$$\frac{\$10,000 \text{ earned revenue}}{\$30,000 \text{ remaining ultimate revenue}^{(1)}} * \$20,000 \text{ unamortized film costs}^{(2)} = \underline{\underline{\$6,667}}$$

Participation costs accrued in Year 2:

$$\frac{\$10,000 \text{ earned revenue}}{\$30,000 \text{ remaining ultimate revenue}^{(1)}} * \$3,000 \text{ remaining ultimate participation costs}^{(2)} = \underline{\underline{\$1,000}}$$

- (1) Computed as follows: Year 2 revised ultimate revenue of \$90,000 minus cumulative prior earned revenue of \$60,000.
- (2) Computed as follows: Film cost of \$50,000 minus cumulative prior amortization of \$30,000.
- (3) Computed as follows: Year 2 revised ultimate participation expense of \$9,000 minus cumulative prior accrual of \$6,000.

EXAMPLE 7
Adjustment of a Participation Liability
That Is in Excess of a Revised
Estimate of Amounts Ultimately Payable
(In Accordance With Paragraph 41)

In accordance with paragraph 41 of this SOP, a participation liability that exceeds the unpaid amount expected to be ultimately payable should be offset against the remaining carrying value of the corresponding film. This scenario can result from changes in ultimate revenue and cost estimates that result in reduced expectations of ultimate participation costs.

Assumptions are the following:

- a. Film cost—\$50,000.
- b. Estimated ultimate revenue:
 - Year 1—\$100,000
 - Year 2—\$80,000
- c. Actual revenue earned:
 - In Year 1—\$60,000
 - In Year 2—\$10,000
- d. Estimated ultimate participation costs:
 - Year 1—\$10,000
 - Year 2—\$0
- e. For Year 1, film cost amortization was \$30,000, and participation costs accrued were \$6,000.

Adjustments of Participation Liability and Film Costs in Year 2:

| | Unamortized Film Costs | Participation Liability |
|--|-----------------------------------|------------------------------------|
| Balance at end of Year 1 | \$20,000 | \$ 6,000 |
| Adjustment to eliminate excess liability | (6,000) | (6,000) |
| Adjusted balances | <u>\$14,000</u> | <u>\$ —</u> |

Film Cost amortization in Year 2:

$$\frac{\$10,000 \text{ earned revenue}}{\$20,000 \text{ remaining ultimate revenue}^{(1)}} * \$14,000 \text{ unamortized film costs}^{(2)} = \underline{\underline{\$7,000}}$$

EXAMPLE 7 (continued)

Participation costs accrued in Year 2:

$$\begin{array}{r} \text{\$10,000 earned revenue} \\ \text{\$20,000 remaining ultimate revenue}^{(1)} \end{array} * \text{\$0 remaining ultimate participation costs}^{(3)} = \text{\$0}$$

- (1) Computed as follows: Year 2 revised ultimate revenue of \$80,000 minus cumulative prior earned revenue of \$60,000.
- (2) Computed as follows: Film cost of \$50,000 minus cumulative prior amortization of \$30,000 and minus the excess participation liability adjustment of \$6,000.
- (3) Estimated ultimate participation costs were reduced to \$0 in Year 2; accordingly, the excess liability was reversed and no further accruals are required.

EXAMPLE 8
Accounting for Costs of Episodic Television
Production Prior to the Establishment of
Secondary Market Revenue Estimates
(In Accordance With Paragraph 33)

Assumptions are the following:

- a. An episodic television series is in its first year of production
- b. Secondary market revenue estimable—none
- c. Cost of production, per episode after the first episode—\$700
 (assume that most of the set costs were accounted for as part of the first episode, which is not illustrated in this example)
- d. Exploitation costs, per episode—\$5
- e. Estimated ultimate revenue per episode:
 Contracted \$400

Secondary market revenue is not estimable per the provisions of paragraph 39(b). Accordingly, capitalization of film costs is limited as follows:

| | Per Episode |
|--|----------------------|
| Revenue contracted | \$400 |
| Production costs to be capitalized | \$400 |
| Exploitation costs expensed | \$ 5 |
| Production costs to be charged directly to expense | \$300 ⁽¹⁾ |

(1) Computed as follows: Total cost of production of \$700, less costs to be capitalized of \$400.

EXAMPLE 9
Illustration of the Individual-Film-Forecast Method
of Amortization, for an Episodic Television Series
(In Accordance With Paragraph 37)

Assumptions are the following:

- a. An entity produces and distributes an episodic television series. Five seasons of the series are ultimately produced.
- b. The entity's fiscal year end corresponds directly with the completion of each production season.
- c. The beginning of Season 4 is when secondary market revenue estimates are initially established.
- d. Costs of production are the following:

| | |
|----------------|---|
| Seasons 1 to 3 | \$36,000 (fully expensed prior to Season 4) |
| Season 4 | \$16,000 |
| Season 5 | \$18,000 |
- e. Earned and remaining ultimate revenues are the following:

As of Season 4

| | |
|--|------------------------|
| Earned and reported in Season 4 | \$ 8,000 |
| Earned and reported in Season 5 | N/A |
| Remaining ultimate revenue, Seasons 1 to 4 | \$40,000 |
| Remaining ultimate revenue, Season 5 | <u> N/A</u> |
| | <u><u>\$48,000</u></u> |

As of Season 5

| | |
|--|------------------------|
| Earned and reported in Season 4 | N/A |
| Earned and reported in Season 5 | \$11,000 |
| Remaining ultimate revenue, Seasons 1 to 4 | \$40,000 |
| Remaining ultimate revenue, Season 5 | <u> \$10,000</u> |
| | <u><u>\$61,000</u></u> |

- f. Ultimate participation costs are as follows:

| | |
|----------------------|---------|
| As of Seasons 1 to 3 | \$ 0 |
| As of Season 4 | \$2,000 |
| As of Season 5 | \$3,000 |

Amortization of film costs in accordance with paragraph 37 of this SOP is determined as follows for Seasons 4 and 5:

$$\text{Season 4 } \frac{\$8,000^{(1)}}{\$48,000^{(2)}} \times \$16,000^{(3)} = \$2,667$$

$$\text{Season 5 } \frac{\$11,000^{(1)}}{\$61,000^{(2)}} \times \$31,333^{(4)} = \$5,650$$

Accrual of participation costs is determined as follows:

$$\text{Season 4 } \frac{\$8,000^{(1)}}{\$48,000^{(2)}} \times \$2,000^{(5)} = \$333$$

$$\text{Season 5 } \frac{\$11,000^{(1)}}{\$61,000^{(2)}} \times \$2,667^{(6)} = \$481$$

(1) Earned and reported revenue during the current season.

(2) Remaining ultimate revenue at the beginning of the current season.

(3) Remaining unamortized film costs at the beginning of Season 4 (\$0 from Seasons 1 to 3, plus the cost of production of Season 4).

(4) Remaining unamortized film costs at the beginning of Season 5 (\$13,333 unamortized as of the end of Season 4 plus the \$18,000 cost of production of Season 5).

(5) Remaining unaccrued participation costs at the beginning of Season 4.

(6) Remaining unaccrued participation costs at the beginning of Season 5 (ultimate cost of \$3,000, less prior cumulative accrual of \$333).

GLOSSARY

This glossary contains definitions of terms or phrases as used in this SOP.

Cross-collateralized. An arrangement that grants a licensee distribution rights to multiple films, territories and/or markets to a licensee, and the exploitation results for all applicable films, territories and/or markets are aggregated by this licensee for purposes of determining amounts payable to the licensor under the arrangement.

Distributor. An enterprise or individual that owns or holds the rights to distribute films. For purposes of this SOP, the definition of distributor of a film does not include, for example, those entities that function solely as broadcasters, retail outlets (such as video stores), or movie theaters.

Entity. Producer or distributor that owns or holds the rights to distribute or exploit films in one or more markets and territories.

Exploitation costs. All direct costs (including marketing, advertising, publicity, promotion, and other distribution expenses) incurred in connection with the distribution of a film.

Film costs. Film costs include all direct negative costs incurred in the physical production of a film, as well as allocations of production overhead and capitalized interest in accordance with FASB Statement No. 34. Examples of direct negative costs include costs of story and scenario; compensation of cast, directors, producers, extras, and miscellaneous staff; costs of set construction and operations, wardrobe, and accessories; costs of sound synchronization; rental facilities on location; and postproduction costs such as music, special effects, and editing.

Film prints. Those materials, produced on behalf of a film distributor for delivery to a theatre or other similar venue, that contain the completed audio and video elements of a film. Such materials are used by the theatre or other similar venue to exhibit the film to its customers.

Firm commitment. An agreement with a third party that is binding on both parties. The agreement specifies all significant terms, including items to be exchanged, consideration, and timing of the transaction. The agreement includes a disincentive for nonperformance that is sufficiently large to ensure the expected performance. In the context of episodic television series, a firm commitment for future production should include only episodes to be delivered within one year from the date of the estimate of ultimate revenue.

Market. A distribution channel within a certain territory. Examples of markets include theatrical exhibition, home video, pay television, free television, and the licensing of film-related products.

Nonrefundable minimum guarantee. Amount paid or payable by a customer in a variable fee arrangement that guarantees an entity a minimum fee on that arrangement. Such a guarantee applies to (a) an amount paid by a customer immediately and (b) an amount that the customer has a legally binding commitment to pay over a license period.

Participation costs. Parties involved in the production of a film may be compensated in part by 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 referred to collectively as *participation costs*. Participations may be given to creative talent, such as actors or writers, or to entities from whom distribution rights are licensed.

Producer. An individual or an entity that produces and has a financial interest in films for exhibition in movie theaters, on television, or elsewhere.

Revenue. Revenue earned by an entity from its direct distribution, exploitation, or licensing of a film, before deduction for any of the entity's direct costs of distribution. For markets and territories in which an entity's fully or jointly-owned films are distributed by third parties, revenue is the net amounts payable to the entity by third party distributors. Revenue is reduced by appropriate allowances, estimated returns, price concessions, or similar adjustments, as applicable.

Sale. The transfer of control of the master copy of a film and all the associated rights that go along with it (that is, an entity sells and gives up all rights to a film). An entity should determine a gain or loss on the sale of a film in accordance with the revenue recognition and cost amortization requirements of this SOP.

Set for production. As used in this SOP, this term means (a) management, with the relevant authority, implicitly or explicitly authorizes and commits to funding the production of a film; (b) active preproduction has begun; and (c) the start of principal photography is expected to begin within six months.

Territory. A geographic area in which a film is exploited. In most cases, a territory consists of a country. However, in certain instances, a territory may be defined as countries with a common language.

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