Accounting for motion picture films (1973); Industry accounting guide; Audit and accounting guide: motion picture industry

American Institute of Certified Public Accountants. Committee on the Entertainment Industries

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This AICPA industry accounting guide is published for the guidance of members of the Institute in examining and reporting on financial statements of companies in the entertainment industries. It represents the considered opinion of the Committee on the Entertainment Industries and as such contains the best thought of the profession as to the best practices in this area of financial reporting. Members should be aware that they may be called upon to justify departures from the Committee's recommendations.

SEYMOUR M. BOHRER, Chairman
DAVID V. BURGETT
CHARLES N. JOHNSON
HAROLD D. KASSEL
ROGER G. MARCELLIN
FRANK H. SPEARMAN III
LEO STRAUSS, JR.
FRED L. TEPPEMAN
FINIS E. WILLIAMS

AICPA Staff:
JOE R. FRITZEMEYER, Director,
Auditing Standards
MYRON J. HUBLER, JR.
Manager, Special Projects
Accounting for Motion Picture Films

Prepared by the Committee on the Entertainment Industries of the American Institute of Certified Public Accountants
# Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Accounting for Revenue</td>
<td>2</td>
</tr>
<tr>
<td>Theatrical Exhibition</td>
<td>3</td>
</tr>
<tr>
<td>Television Exhibition</td>
<td>3</td>
</tr>
<tr>
<td>Discussion of Present Accounting Practices</td>
<td>5</td>
</tr>
<tr>
<td>The Committee's Conclusion</td>
<td>6</td>
</tr>
<tr>
<td>Accounting for Costs and Expenses</td>
<td>9</td>
</tr>
<tr>
<td>Elements of Production Costs</td>
<td>9</td>
</tr>
<tr>
<td>Participations</td>
<td>9</td>
</tr>
<tr>
<td>Exploitation Costs</td>
<td>10</td>
</tr>
<tr>
<td>Allocation of Production Costs to Primary</td>
<td>10</td>
</tr>
<tr>
<td>and Secondary Exploitation</td>
<td></td>
</tr>
<tr>
<td>Amortization</td>
<td>10</td>
</tr>
<tr>
<td>Individual Film Forecast Computation</td>
<td>11</td>
</tr>
<tr>
<td>Periodic Table Computation</td>
<td>12</td>
</tr>
<tr>
<td>Special Inventory Problems</td>
<td>13</td>
</tr>
<tr>
<td>Lower of Cost or Market</td>
<td>13</td>
</tr>
<tr>
<td>Story Costs and Scenarios</td>
<td>13</td>
</tr>
<tr>
<td>Interest Costs</td>
<td>14</td>
</tr>
<tr>
<td>Investment in Films Produced by Independent</td>
<td>14</td>
</tr>
<tr>
<td>Producers</td>
<td></td>
</tr>
<tr>
<td>Balance Sheet Classification</td>
<td>15</td>
</tr>
<tr>
<td>Statement of Changes in Financial Position</td>
<td>16</td>
</tr>
<tr>
<td>Financial Statement Disclosures</td>
<td>17</td>
</tr>
<tr>
<td>Effective Date</td>
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Introduction

Motion picture companies produce and/or distribute films, including those made initially for television, for exhibition throughout the world. Over many years, various accounting methods for recognition of revenues and expenses from the exploitation of films have evolved. These methods have been applied to all types of films (including features, series, and specials made for television) which are exhibited in theaters and licensed for exhibition by individual television stations, groups of stations, or networks. Film costs are classified as inventory and usually represent the most significant asset of motion picture companies. The accumulation of film costs and the amortization of such costs against revenues realized from the films present significant accounting problems.

Other companies may acquire distribution rights to films produced by motion picture companies. To the extent that the accounting practices and other recommendations contained herein are not specifically limited to film production, they are also applicable to companies owning film distribution rights. This industry accounting guide does not apply to accounting by broadcasters for television exhibition rights acquired by license.

The period of time from the acquisition of a story property until distribution or exhibition (referred to as the production/distribution cycle) varies, depending on the release pattern, from a relatively short cycle in the case of quick exploitation films, to relatively long cycles (generally exceeding three years) for films distributed initially in theaters and followed by subsequent distribution on television. Long cycles are characteristic also of films produced for initial exhibition on television (both features
and television series) which are subsequently exhibited in theaters and again on television.

**Accounting for Revenue**

A film is a product, the exhibition rights to which are exploited in the best possible way in various markets for maximum profit. A film is considered by the licensor as a group of rights for individual showings which may be separately sold to exhibitors. Thus, each separate exhibition of a film in any market is unique. For example, there can be only one first-run telecast of a particular film in a given market, and such right is consumed through exhibition by the licensee. A film’s previous exposure in a market will generally have an effect on the price an exhibitor (licensee) is willing to pay for exhibition rights. The price an exhibitor is willing to pay would also be influenced by the audience appeal of the film, the number of authorized showings, and the period of the license.

The revenue and realization principles for recognition of income are set forth in Statement No. 4 of the Accounting Principles Board, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*, as follows:

150. Revenue is conventionally recognized at a specific point in the earning process of a business enterprise, usually when assets are sold or services are rendered. This conventional recognition is the basis of the pervasive measurement principle known as realization.

   **P-2. Realization.** Revenue is generally recognized when both of the following conditions are met:
   
   (1) the earning process is complete or virtually complete,
   
   and
   
   (2) an exchange has taken place.

151. The exchange required by the realization principle determines both the time at which to recognize revenue and the amount at which to record it. Revenue from sales of products is recognized under this principle at the date of sale, usually interpreted to mean the date of delivery to customers. Revenue from services rendered is recognized under this principle when services have been performed and are billable. Revenue from permitting others to use enterprise resources, such as interest, rent, and royalties is also governed by the realization principle. Revenue of this type is recognized as time passes or as the resources are used. Revenue from sales of assets other than products is recognized at the date of sale. Revenue recognized under the realization principle is recorded at the amount received or expected to be received.
Theatrical Exhibition

Motion picture exhibition rights are generally sold to theaters in the larger markets on the basis of a percentage of the box office receipts and for a flat fee in the smaller markets. In certain instances, the licensor may receive a nonrefundable guarantee against a percentage of box office receipts, particularly for high-budget pictures. In many foreign markets, these guarantees are essentially outright sales because the licensor has no reasonable expectation of receiving additional revenues based on percentages of box office receipts, particularly where there is a lack of control over foreign distribution.

The Committee has concluded that the licensor should recognize revenues on the dates of exhibition for both percentage and flat fee engagements. Nonrefundable guarantees should be deferred in the accounts and recognized as revenues on the dates of exhibition, except for guarantees in foreign countries which are, in substance, outright sales. Outright sales should be recognized as revenues on execution of a noncancellable contract.

Television Exhibition

Motion picture rights are generally sold for television exhibition under a contract which typically includes several films (a package) and permits one or more exhibitions of each film during specified license periods. Contracts usually provide an individual license for each film. Fees stipulated in the agreement are usually payable in installments over a period of time which is generally shorter than the period of the licensing contract. The license expires after the last allowed telecast or at the end of the specified period even though the licensee telecasts a film less than the allowed number of times.

A television exhibition license grants the right to telecast a film. When the licensor has signed a noncancellable contract and has delivered the rights to the licensee, the licensor has no remaining significant obligation for performance; thus, at this point the earning process is complete. The licensee obtains the right to exhibit the film during the license period in a manner which, in his judgment, would best exploit such rights. The licensee's actual use of the rights and the passage of time during the license period have no significance for the recognition of revenue by the licensor, since exhibition of the film is subject solely to the discretion of the licensee.

Frequently, the licensee contracts for programming far in advance of the availability date. The licensee is under no obligation
to use the licensed films the allowed number of times but is re-
quired to pay the stipulated fees whether or not all telecasting
rights are exercised. If the licensee does not exercise the contrac-
tual rights, they revert to the licensor with no provision for re-
fund to the licensee.

At present, there are four methods in use for financial report-
ing of revenue from the licensing of films for television. These
methods are the following:

1. **Contract method.** Total revenue is recognized at the date the
   contract is executed.

2. **Billing method.** Revenue is recognized as the installment
   payments become due.

3. **Delivery method.** Revenue is recognized at the date the
   prints are delivered to the licensee.

4. **Deferral or apportionment method.** Revenue is spread evenly
   over the period of the license.

The application of these methods can be illustrated by a com-
parison of revenue recognition under a hypothetical license agree-
ment that specifies the following terms:¹

- End of Fiscal Year—December 31
- Contract Execution Date—July 31, 1973
- Number of Films and Telecasts Permitted—4 films, 2 telecasts
  each
- Fees, License Periods and Print Delivery Dates—

<table>
<thead>
<tr>
<th>Film</th>
<th>Total Fee</th>
<th>Stated License Periods</th>
<th>Print Delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>From</td>
<td>To</td>
</tr>
<tr>
<td>A</td>
<td>$ 800,000</td>
<td>10/1/73</td>
<td>9/30/75</td>
</tr>
<tr>
<td>B</td>
<td>500,000</td>
<td>10/1/73</td>
<td>9/30/75</td>
</tr>
<tr>
<td>C</td>
<td>375,000</td>
<td>9/1/74</td>
<td>8/31/76</td>
</tr>
<tr>
<td>D</td>
<td>225,000</td>
<td>9/1/75</td>
<td>8/31/77</td>
</tr>
<tr>
<td></td>
<td>$1,900,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

¹ For purposes of this illustration only, no consideration has been given to the effect of APB Opinion No. 21, *Interest on Receivables and Payables.*
² The actual license periods expire at the earlier of (a) the second telecast or (b) the end of the stated license period.
• Payment Schedule—$100,000 at contract execution date, $50,000 per month for 36 months commencing January 1, 1974.

• Revenue Recognition—

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract</td>
<td>$1,900,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Billing</td>
<td>100,000</td>
<td>$600,000</td>
<td>$600,000</td>
<td>$600,000</td>
<td></td>
</tr>
<tr>
<td>Delivery</td>
<td>1,675,000</td>
<td>225,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferral</td>
<td>162,500</td>
<td>712,500</td>
<td>712,500</td>
<td>237,500</td>
<td>$75,000</td>
</tr>
</tbody>
</table>

**Discussion of Present Accounting Practices**

The *contract method* recognizes the total license fee as revenue at the date the contract is signed. The primary rationale advanced in support of this method is that the contract signing is the significant event in the earning process. The contract is considered to be the transaction by which the licensor relinquishes the measurable property rights and the licensee acquires those rights. The only remaining performance required of the licensor is delivery of the prints, and the only remaining performance required of the licensee is payment of the stipulated fee. For completed films, the major costs to be matched with the license revenue are determinable at the time the contract is signed and should be accounted for at that time. Thus it is argued that, except in the unusual situation where there is substantial doubt as to the collectibility of the stipulated fee, there is no basis for deferral of revenue recognition. Many contracts include films for which the initial date of the license period is considerably later than the contract date (often to provide for theatrical playout before television showing or expiration of a prior license). Recording license fees for such film rights on the contract date recognizes revenue before the licensor can deliver the right and before the licensee can use it. Further, where the contract covers films not completed as of the contract date, the significant costs to be matched against license revenue generally are not readily determinable.

The *billing method* does not conform to generally accepted accounting principles because it essentially recognizes revenue on

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3 To simplify the presentation, the revenue has been spread evenly over the contract license period.
a cash-flow basis. It has been argued that the billing method approximates installment accounting results rather than cash-basis results and that it is conservative. Paragraph 12 of APB Opinion No. 10 states that the installment method of accounting is applicable only in those circumstances where collectibility is not reasonably assured. However, most licensors have a favorable collection experience and, therefore, installment accounting is generally inappropriate.

The delivery method is used in some industries because it is simple and practical. For instance, a salesman representing a manufacturer may take signed orders which are binding contracts. Nevertheless, in most instances the companies record the sale on product delivery date because this event fulfills the performance required by the sales contract and, thus, is deemed to be a completed transaction appropriate for recognition of revenue. The delivery method has validity when applied to a tangible product, since ownership is unequivocally transferred upon delivery. However, a film right is separable from the copyrighted material included in the print and the physical print itself. In addition, licensee television stations require delivery of the prints in advance of telecast dates in order to insert commercials and to edit for exhibition time requirements. Normally, prints are readily available as of such early delivery date, and storage costs are not significant factors in deciding on early delivery.

The deferral method recognizes revenue over the period of the license because this is generally the period over which the film right can be used and because the licensor has relinquished the right to any alternative use of the film in that market for the stipulated license period. The license period terminates at the specified date or when the last permitted telecast has been made, whichever comes first. Therefore, it is argued that revenue should be recognized throughout the license period. This method overlooks the fact that the licensee's use of the film is limited to a specific number of showings in a particular market, which can usually occur at any time the licensee chooses after the start of the license period. The license period is not intended to provide continued use of the film throughout the term but rather to define a reasonable time period within which the licensee can exercise his limited rights to use the film.

The Committee's Conclusion

The Committee has concluded that a licensing agreement should be considered as the sale of a right. Because of the un-
usual characteristics of a film license, the Committee has further concluded that the revenue from films licensed for television should not be recognized prior to commencement of the license period and not until all of the following conditions have been met:

1. The sales price for each film is known.
2. The cost of each film is known or reasonably determinable.
3. Collectibility of the full license fee is reasonably assured.
4. The film has been accepted by the licensee in accordance with the conditions of the license agreement.
5. The film is available; i.e., the right is deliverable by the licensor and exercisable by the licensee.

Normally, when these conditions are met, both the licensee and the licensor are contractually obligated under a noncancellable license agreement and are able to perform in compliance with all the significant terms of the license agreement. Should options or other factors raise doubt about the obligation or ability to perform on the part of either party, revenue recognition should be delayed until such options or factors no longer exist. Insignificant factors, such as the delivery of a print of a previously accepted film, are not a sufficient basis for delaying revenue recognition. Amendments to an existing license should receive appropriate accounting recognition consistent with the objectives of the recommended method.

In respect to the first condition, the amount of the license fee for each film normally is specified in the contract, and in most cases this amount should be used as the “sales price” for each film, adjusted if required, in accordance with the provisions of APB Opinion No. 21, Interest on Receivables and Payables. In most instances, agreements involving the production of feature films and television series provide for participations by artistic talent and others in film revenues or profits; therefore, there is a strong element of outside influence over the allocation of license fees to individual films. The Committee recognizes, however, that there may be unusual circumstances requiring an allocation of film license fees which is different from that specified in the agreement.

The second and third conditions, that the cost of each film be known and collectibility of the full license fee is reasonably assured, are similar to revenue recognition considerations in general and therefore do not require further discussion herein.
The fourth condition, that the licensee has accepted the film, will usually only be a factor in the initial licensing of a film produced for television since, for subsequent licenses, the particular film is a known product. However, certain feature films included in a package may have ratings such that their eventual acceptance by the licensee is so questionable that it would be necessary to delay revenue recognition for such films until unconditionally accepted by the licensee.

The fifth condition regarding availability distinguishes the recommended method from the contract method in that revenue is not recognized until the right is exercisable by the licensee and all conflicting licenses have expired. Exhibition rights transferred to a licensee generally are definable by geographic market area and are marketed in a manner to avoid conflict in a given market. Conflict may exist in a market between (1) theaters and television stations, (2) network television and local stations, and (3) two or more local stations within the market area. The conflict between theatrical showing and telecasting also is recognized by the producer (or owner) of the film, who usually imposes restrictions on distribution which prohibit the licensing of the film for television for a sufficient period of time to allow for theatrical release. Because of these circumstances, the Committee has concluded that revenue from the licensing of a film should be recognized in the same sequence as the market-by-market exploitation of the film and at the time the licensee is able to exercise his rights under the agreement, which would be the later of the commencement of the license period (the right then being exercisable by the licensee) or the expiration of a conflicting license (the right then being deliverable by the licensor).

Using the hypothetical license agreement in the example on page 4, and assuming no existence of conflicting licenses, revenue recognition under the recommended method would be as follows:

<table>
<thead>
<tr>
<th>Film</th>
<th>License Period</th>
<th>Year of Revenue Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>From To</td>
<td>1973</td>
</tr>
<tr>
<td>A</td>
<td>10/1/73 9/30/75</td>
<td>$800,000</td>
</tr>
<tr>
<td>B</td>
<td>10/1/73 9/30/75</td>
<td>500,000</td>
</tr>
<tr>
<td>C</td>
<td>9/1/74 8/31/76</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>9/1/75 8/31/77</td>
<td></td>
</tr>
</tbody>
</table>

$1,300,000 $375,000 $225,000
Accounting for Costs and Expenses

Industry practice in accounting for the elements of film costs, the amortization of film costs, and the classification of film costs in financial statements has varied. Consequently, the Committee recommends the adoption of uniform methods and appropriate disclosures as discussed in this industry accounting guide.

Elements of Production Costs

Motion picture production costs are accumulated by individual film, generally in four chronological steps: acquisition of story rights, pre-production, principal photography, and post-production. The production costs encompass all costs required to produce a completed film, including stories and scenarios; salaries of cast, directors, producers, extra talent and miscellaneous staff; cost of set construction and operations, wardrobe and all accessories; cost of sound synchronization; production overhead, including depreciation and amortization of studio equipment and leasehold improvements; and rental of facilities on location. Production overhead to be capitalized as a production cost should be consistently allocated among films produced during the period on a systematic and rational basis in accordance with generally accepted accounting principles.¹

Participations

Frequently, talent involved in the production of a motion picture film are compensated, in part or in full, with a participation in the income from the film. Determination of the amount of compensation payable to the participant is usually based on percentages of revenues or profits from the film from some or all sources. Television residuals are a form of participation and are generally based on the number of times the film is exhibited on television. The Committee has concluded that, when it is anticipated that compensation will be payable under the participation agreement, the total participation should be charged to expense in the same manner as amortization, as discussed on page 10, i.e., in the same ratio as current gross revenues bear to anticipated total gross revenues. Appropriate recognition should be given to APB Opinion No. 21, Interest on Receivables and Payables.

¹ Accounting Research Bulletin No. 43, Chapter 4, Statement 3.
Exploitation Costs

Production costs are identified with the completed film from which positive release prints are made for exhibition. Some costs incurred during the final production phase and early release period in both primary and secondary markets which clearly benefit future periods should be deferred and amortized in the manner discussed under the caption “Amortization” below. Examples of such costs are film prints and pre-release and early release national advertising, but these costs should not include rent, salaries, and other period expenses of distribution and co-operative or other forms of local advertising. In no event should these deferred costs, when aggregated with production costs and participations, exceed net realizable value as discussed under the caption “Lower of Cost or Market” on page 13.

Allocation of Production Costs to Primary and Secondary Exploitation

The first market in which a film is exploited is described as the primary market, since such market is the one for which the film was principally produced. All residual exploitation is described as the secondary market. As a general practice, the markets are mutually exclusive, that is, a film cannot be exploited in more than one market at a time, by reason of contract terms or marketing techniques. When a film is expected to be exploited in secondary markets, it is appropriate to allocate a portion of production costs to revenues expected to be realized from secondary exploitation. If the “individual film forecast computation” is used as an approach to amortization of film costs as discussed on page 11, a segregation of the allocated costs is not necessary for amortization purposes although such allocation is required for balance sheet classification. When the “periodic table computation” of amortizing film costs is used, as discussed on page 12, it is necessary to allocate film costs between those markets for which the table is used and other markets.

Amortization

When a film is released and recognition of revenue commences, amortization of the film’s production and exploitation costs is necessary. Amortization should reasonably relate the film
costs to the gross revenue recognized. The Committee has con-
ccluded that a constant rate of gross profit before period expenses
should be recognized, as gross revenue is recorded for each film.
Thus amortization is based on estimated total gross revenue from
the film. The Committee has concluded that the individual film
forecast computation approach should be used; however, the peri-
odic table computation approach may be used if it accomplishes
approximately the same result.

Individual Film Forecast Computation. The individual film
forecast computation amortizes film costs in the same ratio that
current gross revenues bear to anticipated total gross revenues.
Amortization of film costs using the individual film forecast com-
putation requires the determination of a fraction, the numerator
of which is gross revenues from the film for the period and the
denominator of which is anticipated total gross revenues to be
derived from the film during its useful life, including estimated
total gross revenues from foreign exhibition and other established
means of exploitation of such film. In accordance with the pro-
visions of APB Opinion No. 21, Interest on Receivables and Pay-
ables, estimated revenues from long-term, non-interest-bearing
television exhibition contracts should be included in the deno-
inator in an amount equal to the total estimated contract amount
less imputed interest from the date revenues are expected to be
recognized for accounting purposes through the date it is ex-
pected the receivable will be collected; accordingly, the numerator
should exclude that portion of the contract proceeds deemed to
be interest. The resulting fraction is applied to production and
other capitalized film costs to determine the amortization for
each period.

Due to the uncertainties in the estimating process, anticipated
total gross revenues will vary from actual total gross revenues.
Estimates of anticipated total gross revenues should be reviewed
periodically and revised when necessary in order to reflect more
current information. When anticipated total gross revenues are
revised in a period by reason of more current information, a new
denominator is determined. It should include only the anticipated
total gross revenues from the beginning of the current year and
the numerator is the actual gross revenues for the current year.
The revised fraction is applied to the unrecovered film costs (pro-
duction and other capitalized film costs) as of the beginning of
the current year. This method of accounting for changes in esti-
mates is consistent with the requirements of APB Opinion No.
20, Accounting Changes.
The computation of amortization under this method is as follows:

- Film cost $600,000
- Gross revenues:
  - First year $600,000
  - Second year 150,000
  - Third year 50,000
- Anticipated total gross revenues:
  - At end of first year $1,200,000
  - At end of second and third years 1,000,000

<table>
<thead>
<tr>
<th></th>
<th>Amount of Amortization</th>
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<tbody>
<tr>
<td>First-year amortization</td>
<td>$300,000</td>
</tr>
<tr>
<td>$600,000</td>
<td>$600,000</td>
</tr>
<tr>
<td>$1,200,000</td>
<td></td>
</tr>
</tbody>
</table>

Second-year amortization
(anticipated total gross revenues reduced from $1,200,000 to $1,000,000) (a)

<table>
<thead>
<tr>
<th></th>
<th>$112,500</th>
</tr>
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<tbody>
<tr>
<td>$150,000</td>
<td>$150,000</td>
</tr>
<tr>
<td>$400,000 (b)</td>
<td>$300,000 (c)</td>
</tr>
</tbody>
</table>

Third-year amortization

<table>
<thead>
<tr>
<th></th>
<th>$37,500</th>
</tr>
</thead>
<tbody>
<tr>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>$400,000 (b)</td>
<td>$300,000 (c)</td>
</tr>
</tbody>
</table>

(a) If there were no change in anticipated total gross revenues, the second-year amortization would be as follows:

<table>
<thead>
<tr>
<th></th>
<th>$75,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>$150,000</td>
<td>$150,000</td>
</tr>
<tr>
<td>$1,200,000</td>
<td>$600,000</td>
</tr>
</tbody>
</table>

(b) $1,000,000 minus $600,000 or anticipated total gross revenues from beginning of period.

(c) $600,000 minus $300,000 or cost less accumulated amortization at beginning of period.

**Periodic Table Computation.** Amortization provided by periodic tables should approximate amortization which would have been provided had the individual film forecast computation been used and should only be used when such is the result. Periodic tables are based on historical experience information of the income flow and are usually applied only in respect to theatrical distribution. Such tables should be reviewed regularly and updated when-
ever revenue patterns change significantly, and should never be used with respect to a motion picture whose distribution pattern differs significantly from those used in compiling the table, e.g., motion pictures released for reserved seat theater exhibition.

Special Inventory Problems

*Lower of Cost or Market*

A comparison of the unamortized production and exploitation costs with net realizable value should be made each period on a film-by-film basis. When estimated future gross revenues will not be sufficient to recover a film’s unamortized production and exploitation costs, other direct distribution expenses, and participations, a write-down of that film to net realizable value\(^5\) should be made. Adjustments of estimates within a fiscal year should be reflected on a cumulative basis from the beginning of the fiscal year. Previously reported interim results should not be restated.

There may be unusual circumstances under which an inventory write-down to net realizable value must be made prior to the theatrical release of a film. Ordinarily, the evaluation of a film is made after the market has been tested; however, unusual circumstances, such as change in public acceptance of certain types of films or actual costs substantially in excess of budgeted costs, may require a portion of film costs to be written off prior to the film’s release, so that the inventory will not be stated in excess of net realizable value.

*Story Costs and Scenarios*

The cost of film inventories commonly includes expenditures for film rights to books, stage plays, original screenplays, etc. The stories and scenarios generally must be adapted to the production techniques for motion picture films. The cost of the adaptation is added to the inventory cost of the particular property. Such properties should be reviewed periodically, and when it is determined that a property will not be used in production of a film, the cost should be charged to production overhead in the current period. There is a presumption that story costs should be charged to production overhead if the property has been held for

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\(^5\) Accounting Research Bulletin No. 43, Chapter 4, Statement 6.
three years and has not been set for production. Once charged off, story costs should not be reinstated if subsequently set for production.

**Interest Costs**

Motion picture companies often finance the film production with borrowed funds. Indebtedness incurred to finance the production of a specific film is known as a production loan. Also, the production of more than one film may be financed by an arrangement which provides a line of credit. Interest on funds borrowed and expended for film production has in some instances been capitalized as a production cost. The Committee has concluded that it is not appropriate to capitalize interest as a production cost; interest costs are properly treated as a period expense.

**Investment in Films Produced by Independent Producers**

Motion picture companies frequently advance funds or guarantee loans for the production of films by independent producers. Certain legal rights of ownership, including the copyright, may be retained by the independent producer. The motion picture company frequently has a participation in the net revenues from the film. The motion picture company generally has additional attributes of ownership, such as the right to exploit the film and the risk of loss. The financing arrangement usually provides that the production loan by the motion picture company (or a guaranteed loan) is repayable only from the revenues from the particular film. The independent producer does not have general liability with respect to such a loan. Consequently, the motion picture company bears substantially all the risks of ownership.

Some accountants believe that the motion picture company should report only cash advances to independent producers as such in the balance sheet and disclose a contingent liability for loans guaranteed in a footnote. This approach would appear to follow the form of the agreement with the independent producer. Under this approach, the motion picture company would recognize losses at such time as it became evident that the anticipated future revenues from the film will not be sufficient to recover advances made and to repay production loans guaranteed for the independent producer. It is not uncommon for a production loan
to be made for an 18-month term and for the film produced to generate revenues less than the amount of the production loan within its first 18-month period in release. Thus, this approach has the result of not recording the portion of guaranteed production loans which may become due and payable by the guarantor until they are paid. Such circumstances are not uncommon even when the film is ultimately profitable.

Other accountants believe that, since the motion picture company retains substantially all the risks and rewards of ownership, revenues and expenses from a film produced by an independent producer but financed by advances or loans guaranteed by the motion picture company should be reported in the same manner as a film produced without this form of financing.

The Committee has concluded that appropriate reporting for film costs in the balance sheet, as well as in the income statement, should reflect the substance rather than the form of the arrangement with the independent producer. Advances and guaranteed amounts should be accounted for as film costs and the related liability recorded. Revenues and expenses should be reported in the income statement in accordance with guidelines set forth in other sections of this industry accounting guide.

**Balance Sheet Classification**

Motion picture companies generally designate current assets and current liabilities in their balance sheets on the basis of their potential realization or liquidation within 12 months, with one exception. Film costs historically have been classified as a current asset despite the fact that a substantial portion of such inventories customarily will not be realized within 12 months.

The classification of film inventories presents problems in evaluating the financial position of a motion picture company for the following reasons.

First, receivables arising from the exhibition of film inventories which are due more than 12 months after the balance sheet date are classified as non-current. Thus, a film inventory classified as a current asset may be reported later as a non-current receivable from a transaction that brings the inventory cost closer to the point of cash realization.

Second, liabilities generally have been classified as a current liability on the basis of contractual due dates maturing within 12 months from the balance sheet date. Thus, certain liabilities
which may arise from the incurrence of film costs, or which are expected to be liquidated from proceeds obtained upon the realization of film costs, are classified as non-current because they have contractual due dates beyond 12 months from the date of the balance sheet, even though the related film costs are included in current assets.

The Committee has concluded that film costs should be segregated between current and non-current assets. The following film costs should be classified as current assets: unamortized costs of film inventory in release allocated to its primary market; completed films not released reduced by the portion properly allocated to secondary markets; and television films in production which are under contract of sale. Amounts allocated to secondary markets which will not be realized within 12 months and all other costs related to film production should be classified as non-current assets.

The allocated portion of production costs expected to be realized from secondary television exploitation should be reported as a non-current asset. As revenues are recorded from the secondary television market, these allocated costs should be amortized. This treatment avoids the undesired result of inventory costs or receivables generated by sales moving back and forth between current and non-current categories.

Liabilities should be classified as set forth in Accounting Research Bulletin No. 43, Chapter 3, Section A.

The Committee has also concluded that the license agreement for sale of film rights for television exhibition should be considered executory from the time of signing until the time of revenue recognition and, therefore, in accordance with the treatment of other sales commitments, should not be recorded in the balance sheet at the time of signing. Amounts received on such agreements prior to the recognition of revenue should be accounted for as advance payments and included in current liabilities, if such advance payments relate to assets classified as current assets.

Statement of Changes in Financial Position

The statement of changes in financial position should be prepared in accordance with APB Opinion No. 19, Reporting Changes in Financial Position, and should include disclosure of additions to and transfers from non-current inventory.
Financial Statement Disclosures

The Committee has concluded that the financial statements or notes thereto should disclose

1. All accounting policies peculiar to the industry as required by APB Opinion No. 22, Disclosure of Accounting Policies.

2. The components of film inventories, including films released, completed but not released, in process, and story rights and scenarios.


Effective Date

This industry accounting guide shall be effective for all television license agreements signed during fiscal years commencing after June 30, 1973, and for theatrical revenues and costs applicable to films released or completed during fiscal years commencing after June 30, 1973. However, the Committee encourages earlier compliance for all television license agreements signed and theatrical revenues and costs applicable to all films released or completed during the fiscal year in which June 30, 1973 occurs. Appropriate disclosure of the effects of changes should be made in the year of change and in any future year in which revenue or expenses from prior periods have a material effect. The Committee believes that television license agreements entered into and theatrical revenues and costs applicable to films released or completed in fiscal years ending prior to the adoption of the above changes should continue to be accounted for in accordance with the method followed in prior years.

The recommendations for balance sheet classifications and the recording of investments in films produced by independent producers should be adopted retroactively for all balance sheets and statements of changes in financial position issued after June 30, 1973.
Mr. Kassel approves publication with qualification as follows:

He qualifies his assent to the issuance of this statement with respect to the conclusion that it is not appropriate to capitalize interest as a production cost. He believes that treating interest incurred during the production period as a period expense rather than as a part of production costs is inconsistent with the generally accepted accounting principle which provides that the cost of inventories includes expenditures and charges directly or indirectly incurred in bringing an inventory item to its existing condition. He recommends that just as in the case of costs required to be capitalized with respect to unimproved land, interest is properly capitalizable if it results from loans for which productions in process are pledged as collateral or for other loans if the loan proceeds are used for film production. He believes that the Committee's recommended treatment of interest expense will interfere with the proper matching of costs with revenue.

Mr. Tepperman approves publication with qualification as follows:

He disagrees with the conclusions of the guide with respect to the balance sheet classifications of motion picture inventories and receivables. He believes the concepts expressed in this paper are inconsistent with Chapter 3, "Working Capital," of Accounting Research Bulletin No. 43 and result in an arbitrary allocation of these assets between current and non-current classifications without regard to the natural operating cycle of the industry.

He believes that the requirement to expense all interest incurred with respect to debt obtained to finance motion pictures is inconsistent with generally accepted practice in other industries relating to long-lived assets. He believes that there is substantial theoretical support for the inclusion of interest costs directly related to the acquisition of an asset as part of the cost of such asset. As a general matter, he believes it inappropriate to resolve accounting matters of broad interest in an industry accounting guide.
Mr. Marcellin disapproves publication for the following reasons:

He dissents to issuance of the accounting guide because he believes that the guide (1) has not established that the compromise method of accounting for revenue from television exhibition described therein (not presently used by any company) is theoretically superior to other methods presently in use and (2) has not addressed itself to the fundamental question of whether the accounting described is for an item of "inventory" or "property." For example, he believes that in its present indecisive state as to the nature of film costs the guide has no rationale for (1) the immediate expensing of "interest costs" and (2) the film-by-film basis for the lower of cost or market determination, positions which may be inconsistent with principles generally accepted in other situations. Until these matters have been resolved in a logical and sound manner, he believes that the interests of the investor would be better served by not publishing the guide in its present form.