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Accounting for film and TV content in the age of streaming

ASU 2019-02 revisited

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To address changes on the horizon that would impact how media and entertainment (M&E) companies account for feature films, television shows, and other streaming content, in early 2019, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2019-02, *Improvements to Accounting for Costs of Films and License Agreements for Program Materials* (the ASU).

Before releasing the ASU, the FASB's Emerging Issues Task Force included a representative industry working group in its deliberations, which occurred mostly in 2018. At the time, direct-to-consumer (DTC) streaming platforms were run mainly by pure-play, streaming entities.

By the time the ASU was effective for most public M&E companies in fiscal 2020, many legacy M&E organizations had launched their own DTC streaming platforms, which co-exist with traditional linear distribution models. For these companies, the role of, and strategy around, their streaming platforms continues to mature as investors push for growth and profits.

The ASU provides a conceptual framework for film and television content. In many cases, the application of the standard's provisions is not black and white; it requires deeper assessment. Some of these decisions are more challenging than others, particularly considering the industry's fluid streaming business models.

In early 2023, we conducted a confidential informal survey of M&E industry accounting professionals to gauge their responses about the ASU. We asked about how the ASU has been adopted, with a focus on lingering challenges faced by finance organizations within the M&E industry as they apply the requirements of the standard.

This publication represents a collection of our observations. We focused our efforts on the most challenging aspects of the ASU and common trends and practices in these areas.

What's inside

A brief history

Clearly, there have been significant changes in M&E production and distribution models regarding how content is produced, acquired, and ultimately monetized. Over the course of 20 years, media consumption went from analog (VHS, 1977) to digital (DVD, 1997). Ten years later, the technology and delivery mode changed, ushering in the era of on-demand content.

Wherever it goes from here as a business notwithstanding, streaming has come a long way over the last decade and a half. In 2007, demand for streaming video was low. As internet connection speeds ramped up and with the DVD market gradually shrinking, the paradigm for the delivery of entertainment content began a transformation. The M&E industry had migrated from satisfying the public's hunger for entertainment through theater and shipping DVDs to customers' homes to instantaneously beaming original, prerecorded, and live content to subscribers' device of choice.

Today, the ever-evolving DTC streaming business places less weight on any specific film or television series, instead emphasizing vast libraries of content. These massive, cloud-based, "bingeable" libraries have transformed how and why media owners make decisions about what content to produce, acquire, and/or license.

By 2018, it was clear that accounting changes in connection with film and television content were necessary. The M&E industry's long-standing linear distribution model was changing, and the ASU was issued to address the standard accounting requirements for content that had become antiquated.

Significant accounting changes in the ASU

For purposes of this publication, we focus on three key areas of the ASU that industry players point to as especially relevant: film groups, impairment, and amortization.

Film groups

The relevant impairment and amortization guidance in the ASU is dependent upon whether content (a film or license agreement) is considered individually or collectively. To that end, the ASU introduces the film group concept, defined as:

The unit of account used for impairment testing for a film or a license agreement for program material when the film or license agreement is expected to be predominantly monetized with other films and/or license agreements instead of being predominantly monetized on its own. A film group represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other films and/or license agreements.[1]

Determining whether content is part of a film group may require judgment. Further, an entity should reassess its film group decisions to determine if there is a significant change to its predominant monetization strategy (as initially determined when cost capitalization started). The film group assessment considers the entire monetization over the life of the film.

Our take

- The film group decision can be intuitive when, for example, content is produced solely for use on the studio's DTC platform.
- In practice, we observe film groups to be present for films and licensed content used in a studio's streaming platform and for similar content used on broadcast networks because of the absence of significant title-specific revenues in these two situations.
- Film group decisions can be judgmental when the content will be monetized in various ways or when an entity's monetization strategy is undergoing change.
- Film group decisions are critical for M&E companies. This is because the pivot away from legacy prescriptive accounting guidance to the ASU's more conceptual requirements starts with the film group decision.

[1] Financial Accounting Standards Board, ASU 2019-02, *Improvements to Accounting for Costs of Films and License Agreements for Program Materials*.

Impairment

The ASU requires impairment to be predicated on an entity's determination of whether content is part of a film group.

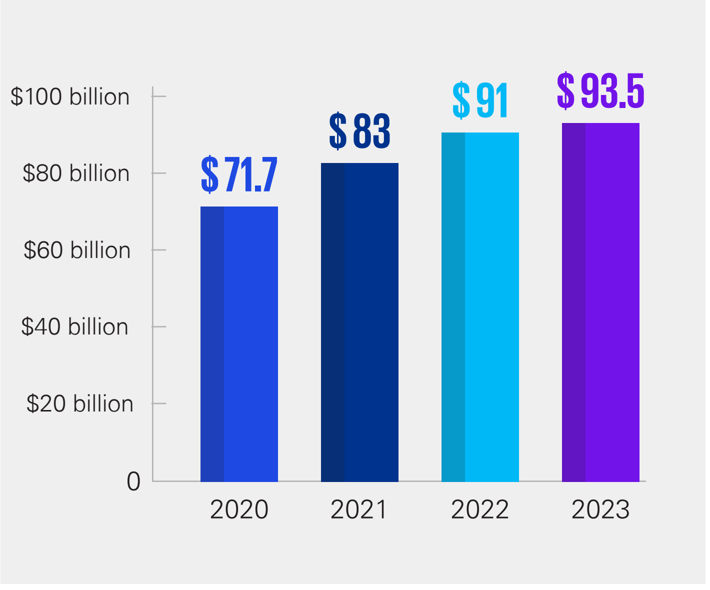
Before the ASU became effective, under legacy Accounting Standards Codification (ASC) 926, produced content was tested for impairment individually under a fair value model. Separately, licensed content was tested under legacy ASC 920 for impairment individually or in groups—dayparts, for example—under a net realizable value model.

The ASU merges the impairment testing requirements across produced and licensed content and added impairment indicators (triggers) directed at circumstances that occur after a film is released. In addition, the ASU adds a requirement to write off content when a film is substantively abandoned.

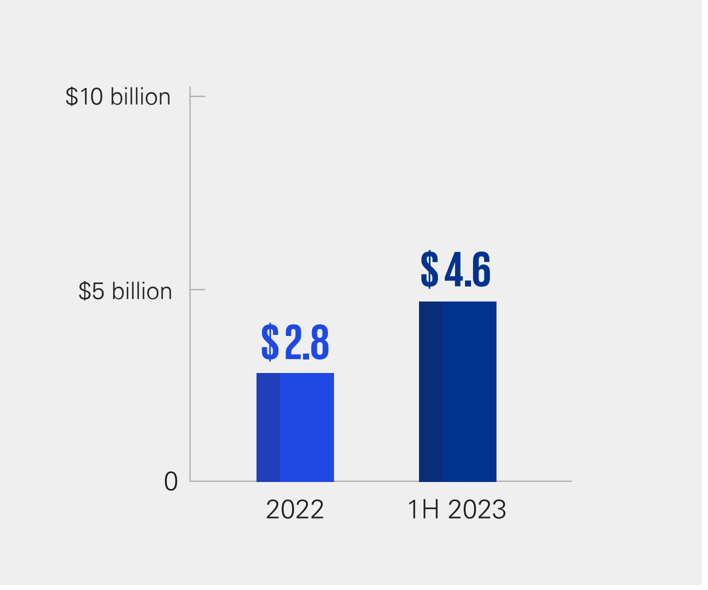
Our take

- Film group impairments are much less frequent than individual film impairments because a portfolio of films and licensed content naturally provides more consistent cash flows.
- An underperforming title that may be impaired if evaluated individually may not be impaired when part of a film group.
- As a practical matter, we see impairments arise primarily from strategic abandonments of films as a byproduct of the significant investments in content during the industry's "streaming wars"—a period of massive spending aimed at growing streaming subscribers to establish scale in the emerging space.

The cost of streaming content over the last four years has exploded as M&E companies seek the attention of consumers…



…but, more recently, ambitions of scale have turned to a focus on profitability, with M&E companies booking impairments more than $1 billion.



Source: Form 10-K and Form 10-Q filings by a representative group of M&E companies.

Amortization of content that is part of a film group

Under ASC 926, produced content that is not part of a film group is amortized using an individual film forecast model (commonly referred to as an "ultimates model" or simply an "ultimate").

The ultimates model is fairly prescriptive and requires amortization of costs using the ratio of current-period revenue to estimated remaining unrecognized revenue as of the beginning of the fiscal year.

For produced content that is part of a film group—bearing in mind that such content typically does not have title-specific revenue needed to apply an ultimates model—the ASU requires amortization of each film to represent management's "reasonably reliable estimate of the portion of unamortized costs that is representative of the use of the film."[2]

Significant judgment may be required to determine the amount of use of a film that's part of a film group.

Our take

- For film producers, the transition from using an ultimates model to the conceptual "usage model" presents a considerable change.
- The absence of prescriptive guidance in the ASU provides for latitude and requires judgment in the quantification of film usage.
- Practice is mixed with respect to the specific policies, models, and data used to determine the pattern of usage.

[2] Financial Accounting Standards Board, ASU 2019-02, *Improvements to Accounting for Costs of Films and License Agreements for Program Materials*.

Questions around and applications of the ASU

Through the course of our survey of M&E accounting professionals, a number of specific questions arose. Here, we offer practical responses—organized by film group, impairment, and amortization.

Film group questions

When is the film group decision made?

While monetization strategy should be determined when cost capitalization begins in the ASU, management may reevaluate the strategy during the period of production.

As the ASU notes, "If there is a significant change to the monetization strategy of a film compared with the monetization strategy determined when capitalization of film costs began, an entity shall reassess the predominant monetization strategy for that film."[3] The ASU does not define "significant change" but does provide examples:

- Adding a previously unplanned distribution channel.
- Forgoing a previously planned significant distribution strategy.

Consequently, we believe the reassessment of film groups is something management would consider only to the extent there is a trigger. It's worth noting that a significant change in monetization strategy typically excludes the following scenarios:

- Since the film group assessment considers the entire life of the film, a film that is in the later stages of its monetization life is not likely to have a change to its predominant monetization strategy.
- The film group reassessment is only about changes in monetization strategy; whether the film's performance meets expectations is generally moot in this context.

[3] Financial Accounting Standards Board, ASU 2019-02, *Improvements to Accounting for Costs of Films and License Agreements for Program Materials*.

What information is important to the determination of film groups?

Information used by management to assess their film groups typically includes:

- Green light budgets
- Release plans
- Historical distribution patterns and results for similar films.

What does "predominantly monetized" mean— is there a percentage?

The ASU does not directly define "predominantly monetized." It's helpful to consider the definition of "film group," which results in a qualitative assessment of an entity's monetization strategy rather than a quantification of direct and indirect cash flows. When the predominant monetization strategy is not clear and management needs to consider quantitative information, we believe that "predominant" and "largely" suggests there is at least a 50 percent threshold when determining if content is part of a film group.

Film group decisions may require judgment, such as when management has multiple distribution windows for a film. For original content, we believe the venue used for a film's initial exhibition, or premiere, is informative for the film group decision. Specifically, if the initial exhibition is a stand-alone monetization, such as a theatrical run, then the film may not be part of a film group. However, if the film premieres on a streaming platform, then it may be part of a film group.

If management needs to quantify the expected cash flows of a film to determine the extent of independent versus group cash flows, then this can be a classically circular process in which the M&E entity needs to prepare cash flows for an individual film, presumably with allocations of group cash flows.

What types of film groups are typical?

We see film groups in two primary areas:

1 Streaming platforms

This film group may aggregate content across platforms that share common content and generally incorporate all tiers of service (free, ad-supported, and paid). A streaming platform often qualifies as a film group because the primary, or sometimes only, revenue stream is subscription-based. Some streamers have a free, ad-supported tier; this tier may be considered a "feeder" service meant to drive consumers toward subscription. Thus, the free tier is combined with the paid tiers.

M&E companies should keep an eye on the expansion of advertising on streaming platforms because advertising can be targeted for display against specific content, such as pre-roll and digital banner ads.

2 Linear networks

This film group may include networks that share common content. A linear network often is considered a film group because the primary revenue stream is carriage fees, the monthly fees paid by multichannel video programming distributors to include the network's linear feed in its consumer subscription packages. Like streaming film groups, M&E companies should consider the extent of advertising sales that are placed to run during specific programs on its linear network.

The decision about whether a film has cash flows that are "largely independent of the cash flows of other films or license agreements"[4] requires judgment. It's certainly possible that two well-reasoned M&E companies may arrive at different conclusions on an analysis of the same information.

In the case of a film on a streaming platform, one M&E entity may believe the film is not part of a film group, and management may proportionally attribute streaming subscription revenue to the film. Another M&E entity may look at the same fact pattern and determine the same film is indeed part of a streaming film group. We believe both M&E entities may have supportable positions because of the judgments applied by management.

From a practical perspective, attributing one portion of amortization of a film to a film group usage curve and another portion to an ultimate model may be a reasonable approach for computing amortization of a film. We see this accounting when M&E companies license rights to third parties and use the same content its own platforms. However, the application of the impairment guidance in the ASU necessitates a decision about whether a film is included in a film group.

May M&E entities that have a production studio determine that internally produced films have separately identifiable cash flows?

Yes, for a production studio that is viewed as a profit center by the M&E entity, the studio's financial results typically reflect market-based license fees for its films and this may inform management's film group decisions. For the stand-alone bookkeeping at the production studio, the individual film ultimates model may already be in place. Further, segment reporting in the M&E company's financial statements may reflect the studio's accounting for its content as separate units of account. In this situation, the stand-alone accounting for intercompany licensing transactions between the production studio and streaming and broadcast business units is eliminated in consolidation. However, the application of the impairment guidance in the ASU necessitates a decision about film groups that is based on third-party transactions outside of the reporting entity.

Impairment questions

Do streaming service negative cash flows indicate film group impairments?

We generally do not see impairments of film groups based on a fair value assessment. This is because video streaming is still an immature business model, and management's expectations for streaming may include a period of negative cash flows. However, tides are changing, winners and losers will emerge, and film group impairments for streaming assets may become more prevalent as the industry matures.

As noted above, we typically see impairments of individual films primarily from abandonments. The ASU added a new derecognition criteria, "An entity shall write off remaining unamortized film costs when a film is substantively abandoned."[5] Abandonments of content can be attributed to several scenarios, including:

1. M&A activity that results in changes to strategic plans for streaming services
2. Restructuring activities within an organization
3. A pivot away from a "more is more" approach to a "less is more" stance with a goal of creating a better user experience
4. Content abandonments that may reduce future content amortization and talent-related expense.

We would expect an impairment resulting from a management decision to abandon content would be evidenced by the operational consequences, namely the removal of content available for use by programming and sales departments.

[4, 5] Financial Accounting Standards Board, ASU 2019-02, *Improvements to Accounting for Costs of Films and License Agreements for Program Materials.*

Which impairment triggers in the ASU are noteworthy?

Two impairment triggers are of note:

1 The ASU contains an antiabuse provision that requires an impairment test regarding "A change in the predominant monetization strategy of a film resulting in the film being predominantly monetized with other films and/or license agreements."[6] For example, an M&E entity may divert a film that underperforms in its theatrical release to its own streaming platform instead of following its previous plan to license the film to third parties. As a result, management may determine the film should be included in a streaming film group. In this situation, the M&E entity should assess the film for impairment before its included in the streaming film group.

2 The ASU introduced two new film group impairment indicators related to operating cash flow losses and subscriber trends. Given the newness of the streaming business models and the more recent focus by M&E entities on streaming profitability, we may see these impairment indicators play a more prevalent role in the evaluation of film group impairments.

Amortization questions

What are the typical models that are used to support film group usage amortization?

The ASU does not provide prescriptive guidance for determining a reasonably reliable estimate of the use of a film that is part of a film group. In general, we've seen the following data elements and models used to depict usage:

1 Streaming curve

This model refers to the number of current-period streams relative to total projected streams and is used for streaming platform film group content. Typically, streaming data is available at the title level. However, for many new streaming platforms, the extent of historical streaming data is limited.

M&E entities should consider factors that indicate historical consumer streaming curves may not be a persuasive indicator of future consumer habits, especially for titles with longer usage curves.

The consumer demand for new content results in a steeper usage curve. Industry participants are typically weighting all streams the same, although some observers believe streams of newer content should be weighted more than streams of older content, which would further steepen the usage curve of new content. For example, a premiere film on a streaming platform may drive new subscribers to the platform; consequently, the representative use of premiere film streams may be higher than streams of back-catalog content.

2 Network play pattern

This model refers to the number of current-period broadcasts/plays relative to total projected broadcasts/plays and is typically used for linear network film groups. If applicable, the number of forecasted plays may be subject to contractual limits for licensed content.

In contrast to streaming, the number of plays on a linear network is within management's control and is evidenced in programming schedules. However, programming schedules may not extend for the life of a film or license agreement.

[6] Financial Accounting Standards Board, ASU 2019-02, *Improvements to Accounting for Costs of Films and License Agreements for Program Materials.*

3 Revenue forecasting

This method for amortization of a film that is part of a film group involves the inherent inconsistency of creating title-specific financial forecasts for a film that is predominantly monetized with other films. However, the upside may relate to talent reporting obligations, referred to as "participations," which may require title-specific financial information. The effort required for participations accounting could provide a basis for determining amortization.

4 Policy method, accelerated, and straight-line

In practice, for original films, most M&E entities are applying an accelerated amortization curve, which is consistent with practice before the ASU was issued. Indeed, the FASB noted in the ASU's basis for conclusions that most film costs are amortized on an accelerated basis and generally have short amortization lives.

However, in some instances, straight-line amortization of a film that is part of a film group may be appropriate. This measure of usage is typically associated with content that is licensed in a secondary distribution window. Nonetheless, we expect that management's basis to use straight-line amortization is rooted in a measure of use that reflects a consistent pattern of usage.

Can usage models be applied consistently across films with similar characteristics in a portfolio approach?

Yes, films with similar usage characteristics may occur when, for example, films display some or all the following attributes:

1. The films are in the same film group
2. The films are of the same/similar genres
3. The films appeal to a similar consumer demographic
4. The films display similar usage metrics, i.e., streaming curves.

A portfolio approach is not addressed in the ASU; however, we believe it is reasonable to leverage the portfolio approach concepts in ASC 606-10, with respect to revenue accounting for multiple contracts with customers that says, "an entity may apply this guidance to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts..."[7]

With materiality in mind, the qualitative grouping characteristics of a portfolio of films should be readily apparent (attributes 1–3). Additionally, M&E companies may perform quantitative studies to indicate that the usage metrics of films that are grouped for amortization to exhibit similar usage patterns (criteria 4).

[7] Financial Accounting Standards Board, ASC 606-10, *Revenue form Contracts with Customers (Topic 606)*.

KPMG is ready to help

The digital disruption that M&E companies were already facing has accelerated. We've seen it in digital delivery of content (streaming versus cable), the movement of advertising dollars to digital channels, and tech-enabled virtual events.

M&E companies need to make quick, confident decisions to navigate the evolving business landscape and capture opportunities where they are emerging.

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- Interpretation of changes in both U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) and advice on how to meet new requirements
- Technical research, including analyses of guidance from the Financial Accounting Standards Board (FASB), SEC and International Accounting Standards Board (IASB), and actions taken by public companies, as well as those in our extensive client base.

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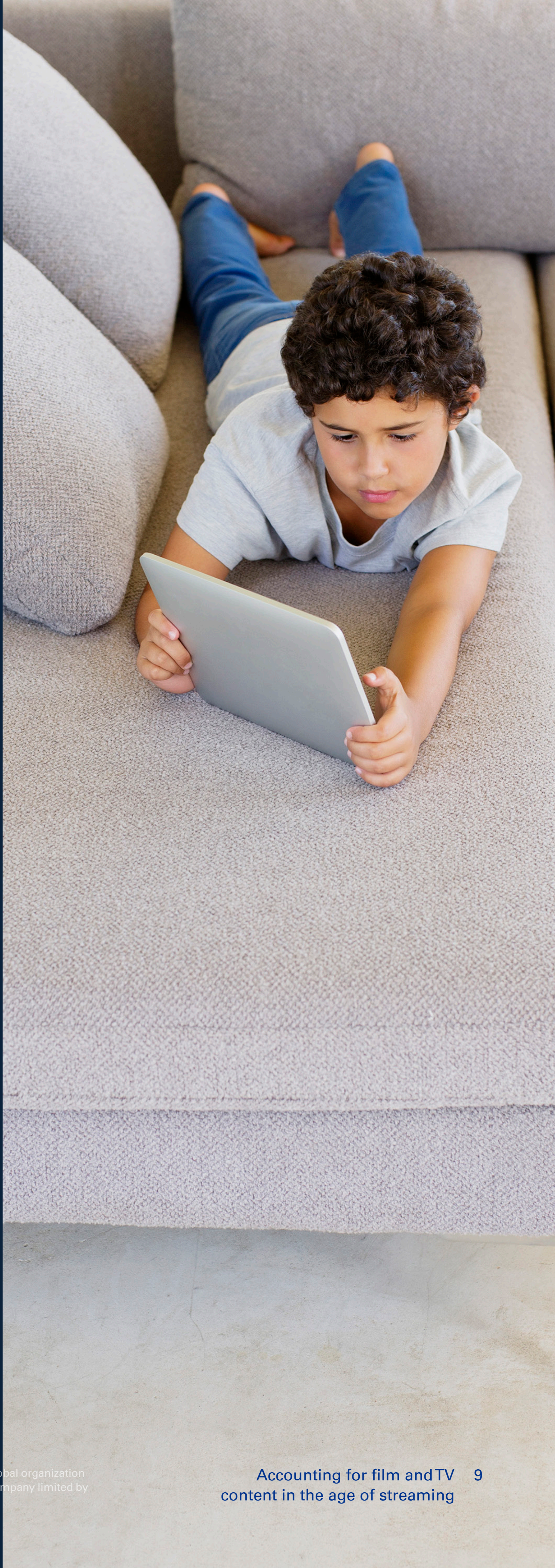

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