

Accounting and Reporting Developments for Media Companies

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Introductions

- Lori Brock, VP Finance - Meredith Corporation
- Wilson Matheson, PwC Assurance Partner
- Eric Sullivan, PwC Assurance Director

Agenda

- Covid-19 considerations
- CECL considerations
- Cloud computing considerations
- Content accounting under ASU 2019-02

COVID-19

Accounting and reporting considerations

COVID-19 considerations for media companies

Area	Specific business implications	Accounting considerations
Advertising	Advertisers may seek accommodations to the arrangement in the form of reduced pricing, extended payment terms, incremental free or discounted ad spots, enhancements to advertising guarantees, or changes in the originally agreed time slot	<ul style="list-style-type: none">• Consideration will be needed as to whether the modification impacts the number of performance obligations, price or both• The application of the modification guidance is specific to the facts and circumstances
Affiliate revenues	Certain affiliate arrangements and retransmission agreements include covenants tying such fees to a number of live events or a minimum number of new content hours during a measurement period	<ul style="list-style-type: none">• Consideration of protection under force majeure provisions• Consideration of whether provisions in affiliate agreements require a refund of affiliate fees• Consideration of downstream impacts (e.g. bad debt provisions in affiliate arrangements)

COVID-19 considerations for media companies

Area	Specific business implications	Accounting considerations
Program assets	The programming funnel for many companies has been disrupted by the pandemic and ensuing shutdowns to production studios. This may have impacted the utilization of existing content and might have rendered certain content as obsolete	<ul style="list-style-type: none">• Under the new content accounting guidance, changes to amortization patterns to assets in a film group are applied prospectively• Under the new content accounting guidance, the unit of account for impairment for much content may have changed to the film group level• Assets that are substantively abandoned would be impaired
Sports rights	Sports leagues were suspended and have only recently begun to crystallize their plans for continuing or starting seasons, many of which will look very different than were originally planned. Companies must consider the timing and pattern of recognition of expense for license fees.	<ul style="list-style-type: none">• Contractual rights with respect to force majeure provisions / refund rights should be assessed• The allocation of license fees for delayed or truncated sports seasons requires judgment and the accounting models can be complex

COVID-19 considerations for media companies

Area	Specific business implications	Accounting considerations
Goodwill and intangibles impairment assessments	There have been significant near-term interruptions to business as usual including meaningfully reduced expectations relative to advertising by customers in Q2/Q3 and cancellations / delays of programming. Secular declines in linear television may have been accelerated by the pandemic and ensuing economic recession.	<ul style="list-style-type: none">• Revised 2020 forecasts• Impact to long-term outlook, including timing and extent of expected recovery• Step 2 has been eliminated from the goodwill impairment model
Debt, liquidity and going concern assessments	Borrowing agreements with third parties can contain financial covenants which if breached can trigger immediate repayment or other negative consequences	<ul style="list-style-type: none">• Assessment of compliance with covenants is critical to determine the appropriate presentation of borrowings• Going concern assessments must first consider whether there is “gross risk”, then an assessment is performed to determine whether this gross risk has been mitigated• The existence of gross risk requires disclosure in the financial statements

COVID-19 considerations for media companies

Area	Specific disclosure implications	Accounting considerations
Financial statement disclosures	GAAP and SEC rules require disclosure of items impacting the results of operations, risks and uncertainty and liquidity.	<ul style="list-style-type: none"> • ASC 275 disclosures are required in the footnotes to address areas of estimation and uncertainty • Risk factor language should be updated to reflect all material changes to risks since the Form 10-K • MD&A liquidity disclosures should provide visibility into the entity's perspectives relative to the impact on future liquidity and operating performance
Non-GAAP adjustments	For impacts of COVID-19 to earnings (e.g. impairments, incremental non-recurring costs), Company considered Regulation G, Item 2.02, and Item 10(e) regulations for inclusion of non-GAAP adjustments and appropriate disclosures.	<ul style="list-style-type: none"> • Non-GAAP adjustments will be included in upcoming earnings releases and periodic filings for incremental costs from COVID-19, including disclosure of how the measure is useful to investors. • Adjustments are for actual amounts incurred rather than hypothetical amounts.
Internal controls over financial reporting	With global office closures and remote working practices instituted, companies are required to execute the quarter-close and financial reporting controls remotely	<ul style="list-style-type: none"> • Item 4 disclosures should be updated to reflect material changes in internal controls that occurred during the quarter

Polling Question #1

Current expected credit losses ("CECL")

Accounting considerations

CECL overview

Overview

- This standard applies to a number of financial instruments, the most common of which for media companies is trade accounts receivables
- Historical GAAP required the recognition of credit losses (bad debt) under an as-incurred model
- New GAAP requires the recognition of expected credit losses based upon management's expectations relative to credit losses which are anticipated to occur over the life cycle of the financial instruments
- Given the increased level of estimation and judgment, disclosure requirements with respect to management judgments have increased

Key takeaway: The timing of loss recognition is generally accelerated under the new standard

CECL: COVID-19 considerations

Application in the current environment

- The macroeconomic impact of the current pandemic has in many instances reduced the relevance of historical bad debt experience when assessing expected credit losses and increased the need to apply management judgment
- Examples of leading indicators to consider:
 - Customer industry/sector exposed to greater cash flow risks (e.g. airline, hotels, non-essential traditional retail)
 - Aging status of more recent receivables compared to historical client-specific aging
 - Customers who have requested concessions on either payment terms or pricing discounts
 - Companies receiving funds from the government under the C.A.R.E.S. Act
- Operational considerations:
 - CECL implications sometimes recorded as general reserve vs. client-specific
 - Tracking for future utilization if/when accounts receivable written off
 - External segment reporting mapping of general reserves

CECL: COVID-19 considerations

Disclosures

- ASC 326 introduces various qualitative and quantitative disclosure requirements. The main purpose of these disclosures is to:
 - *enable financial statement users to understand the credit risk inherent in the company's portfolio,*
 - *to understand how management monitors credit risk,*
 - *to provide insight as to how management develops estimates of expected credit losses, and*
 - *disclose the changes in those estimates during the reporting period.*
- New disclosures include “vintage” disclosures by **credit quality indicator, rollforwards** of the allowance for credit losses, and qualitative descriptions of **how expected loss estimates are developed**.
 - For trade receivables, the allowance for doubtful accounts is required to be presented on the face of the balance sheet, and a rollforward of activity is required to be disclosed in the notes.

Key takeaway: Clear disclosure with respect to estimation methodology can enable users of the financial statements to better understand balance sheet risks in the portfolio

Cloud computing costs

Accounting considerations

Cloud computing costs overview

Overview

- This standard was issued to address diversity in practice with respect to the accounting for implementation costs incurred in connection with a cloud computing arrangements
- These arrangements are those where a company acquires the right to use a software that is hosted by a third party in their environment / on their hardware
- Certain costs incurred in the implementation phase of a cloud computing arrangement such as a software-as-a-service (“SAAS”) arrangements will be capitalized and recorded as a prepaid expense
- These capitalized costs will be expensed over the service period and reflected in the same line item as the underlying SAAS arrangement costs
- These costs would be considered as operating cash flows on the statement of cash flows
- Processes and controls may require modification to identify, track and record these costs

Key takeaway: While these costs should be capitalized, the presentation and disclosure of these costs will differ significantly from those incurred in connection with capitalized internal-use software

New GAAP – compare and contrast to internal-use software guidance

Areas	Cloud arrangement	Internal-use software
Capitalization criteria	Apply cost capitalization guidance similar to internal-use software guidance under ASC 350-40	Capitalize costs in the application and design stage or those that result in significant upgrades to functionality
Balance sheet classification	Typically reflected as a prepaid expense or other asset	Internal use software, typically reflected as a component of PP&E
Income statement classification	Reflected in the same line item as the SAAS costs, typically in SG&A	Reflected as amortization expense
Statement of cash flows	Reflected as an operating cash outflow	Reflected as an investing cash outflow

Polling Question #2

Content accounting considerations

Summary of historical GAAP

Historical GAAP

Overview

- Historical GAAP was written at a time when content was delivered in a significantly different manner than content is delivered today (e.g. theatrical pictures largely released in theaters, episodic television largely exploited via linear television feed and licensing arrangement to other linear television providers)
- Historical GAAP contained significant differences between the accounting rules for licensed content (ASC 920) vs. owned-content (ASC 926)
- This industry-specific GAAP was written through the lens of acknowledging the differences at the time between film assets and other intangibles, recognizing the differences in the nature of the assets and the resultant cash flows from exploitation

Key takeaway: Historical GAAP rules were written before many of the platforms that content is exploited today were prevalent. A fundamental refresh was considered necessary by the EITF to reflect the current environment.

Historical GAAP – two models

ASC 920

- Historical/Current GAAP which is applicable in instances where entities license content from the IP owners for a finite number of runs or a discrete period of time
- Examples include output deals from other content producers, sports rights, etc where the licensee does not acquire the perpetual rights

ASC 926

- Historical/Current GAAP which is applicable in instances where entities acquire the perpetual rights to the IP, whether specific to a particular territory (e.g. US rights only or full international rights) or specific to a particular platform (e.g. linear or digital only rights)

Key takeaway: Nature of IP rights is determinative as to which accounting model to follow

Historical GAAP – compare and contrast ASC 920 and ASC 926

Areas	ASC 920	ASC 926
Initial capitalization	Driven by direct cost inherent in license arrangement	Capitalize direct costs up to level of proven revenues
Timing of recognition	Earlier of date of payment or license start date and date show is available for airing	As content is produced / milestone deliveries are made
Balance sheet classification	Amount of asset that is expected to be amortized in the ensuing 12 months should be classified as current	Classified as noncurrent asset

Old GAAP – compare and contrast ASC 920 and ASC 926

Areas	ASC 920	ASC 926
Amortization	Generally runs-based, patterns aligns with expected exploitation which can result in accelerated model	Individual film forecast model designed to ensure consistent margin from exploitation over time – <u>changes applied retro to the beginning of the fiscal year</u>
Useful life	Generally determined based upon license period, not to exceed 10 years – changes would be applied prospectively from date of change	Based upon expected usage, not to exceed 10 years – changes would be applied prospectively from date of change
Impairment	Applies an NRV model – impairment triggers are slightly different	Applies a fair value model

Historical GAAP - ASC 926: Capitalization considerations

Capitalization Criteria: Episodic Television Series

25-6 For an episodic television series, ultimate revenue (see discussion of ultimate revenue in paragraphs 926-20-35-4 through 35-8) can include estimates from the initial market and secondary markets. **Until an entity can establish estimates of secondary market revenue in accordance with paragraph 926-20-35-5(b), capitalized costs for each episode produced shall not exceed an amount equal to the amount of revenue contracted for that episode.**

An entity shall expense as incurred film costs in excess of this limitation on an episode-by-episode basis, and an entity shall not restore such amounts as film cost assets in subsequent periods. For more information, see Example 3 (paragraph 926-20-55-9).

25-7 Once an entity can establish estimates of secondary market revenue in accordance with paragraph 926-20-35-5(b), the entity shall capitalize subsequent film costs. **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 shall not immediately expense costs in excess of contracted-for-revenue.**

Key takeaway: Capitalization was limited under historical GAAP rules to recoverability by contracted revenue streams until sufficient history exists to support recoverability of costs which results in immediate expensing of many costs for pilots of episodic television series and growth stage businesses (e.g. digital)

Historical GAAP – impairment considerations

- Impairment triggers have focused predominantly on title-specific factors for owned-content and daypart considerations for licensed content:
 - Ratings for premier which deviate significantly from average ratings in time slot / ratings for daypart which deviate significant from average ratings
 - Significant length of time since the last airing
 - Volume of airings necessary to recover carrying value is in excess of time available to air / expectations relative to future utilization

Key takeaway: Impairment controls were designed to assess for impairment under the old GAAP model and will likely require reconsideration under new GAAP (e.g. film group concept)

Content considerations

Changes to GAAP under ASU 2019-02

New GAAP – compare and contrast ASC 920 and ASC 926

Areas	ASC 920	ASC 926
Initial capitalization	Driven by direct cost inherent in license arrangement	<i>Capitalize direct costs – requirement to have proven revenues reduced and allows for incorporation of indirect revenue streams (e.g. affiliate and retransmission fees)</i>
Timing of recognition	Earlier of date of payment <u>or</u> license start date <u>and</u> date show is available for airing	As content is produced
Balance sheet classification	<i>Eliminates requirement to segregate current vs. non-current</i>	Classified as noncurrent asset

New GAAP – compare and contrast ASC 920 and ASC 926

Areas	ASC 920	ASC 926
Amortization	Generally runs-based, patterns aligns with expected exploitation which can result in accelerated model	Individual film forecast model designed to ensure consistent margin from exploitation over time + <i>introduction of film group concept</i>
Useful life	Generally determined based upon license period, not to exceed 10 years – changes would be applied prospectively from date of change	Based upon expected usage, not to exceed 10 years – changes would be applied prospectively from date of change
Impairment	<i>Now applies a fair value model + introduction of film group concept as level of assessment and is applied pro rata in a film group</i>	Applies a fair value model + <i>introduction of film group concept as level of assessment and is applied pro rata in a film group</i>

New GAAP – compare and contrast ASC 920 and ASC 926

Areas	ASC 920	ASC 926
Disclosure	<i>Segregate films monetized individually vs. those used in film groups</i>	<i>Segregate films monetized individually vs. those used in film groups</i>

Content– Impairment considerations

Film Group Definition – EITF 18-B

The unit of account for impairment testing for a film and a license agreement for program material where the film or license material is expected to be predominantly monetized with other films and license agreements instead of being 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 or license agreements.

Key takeaway: In practice we have observed many entities concluding that a large amount of their content is part of a film group

Content – Impairment considerations

ASC 926-20-35-12B

The following are examples of events or changes in circumstances for a film group that indicate that an entity shall assess whether the fair value of a film group is less than its unamortized film costs:

- A significant adverse change in technological, regulatory, legal, economic, or social factors that could affect the fair value of the film group;
- A significant decrease in the number of subscribers or forecasted subscribers, or the loss of a major distributor;
- A current period operating or cash flow loss combined with a history of operating or cash flow losses or projection of continuing losses associated with the use or exploitation of a film group

Key takeaway: The unit of account for impairment assessment for content in a film group has changed and therefore requires assessment of a different set of triggering events

Content – Impairment considerations

ASC 926-20-35-19

An impairment loss attributable to a film group shall reduce only the carrying amounts of the film or license agreement of the film group. The loss shall be allocated to the films and license agreements within the film group on a pro rata basis using the relative carrying amounts of these assets, except that the loss allocated to an individual film or license agreement of the film group shall not reduce the carrying amount of the asset below its fair value whenever that fair value is determinable without undue cost and effort.

Key takeaway: Impairment charges to content assets in a film group are allocated pro rata to all titles

Polling Question #3

Resources

- *COVID 19 and the Media Industry*
 - <https://www.pwc.com/us/en/library/covid-19/coronavirus-impacts-media.html>
- *In the Loop: Moving to the cloud? Better check the new cost guidance*
 - <https://www.pwc.com/us/en/cfodirect/assets/pdf/in-the-loop/moving-to-cloud-computing-costs.pdf>
- *In Depth: How the credit impairment standard impacts non-financial services companies*
 - <https://www.pwc.com/us/en/cfodirect/publications/in-depth/cecl-non-financial-services.html>
- *Perspectives: Changes to accounting for film costs and license arrangements*
 - <https://www.pwc.com/us/en/industries/tmt/library/assets/pwc-final-changes-to-accounting-for-film-costs-and-license-agreements.pdf>

Questions?

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