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Media & Entertainment Spotlight

Impairment of Unamortized Film Costs

In This Issue:

The Bottom Line

- The uncertainties associated with a film's success can result in various challenges related to the testing of unamortized film costs for impairment because of the judgments, estimates, and assumptions that are applied.
- During a film's production, its capitalized cost generally approximates its fair value. On or near its release date, a discounted cash flow model is usually used to estimate the fair value of a film, since this is typically the point at which reliable cash flow projections can be made.
- Under a discounted cash flow model, cash inflows should include all cash flows an entity expects to generate from a film, which may differ from the ultimate revenues the entity uses to determine the amortization of capitalized film costs under the individual-film-forecast-computation method.
- Cash outflows should incorporate all outflows necessary to generate the film's cash inflows, including, but not limited to, exploitation costs (such as marketing and promotional expenses) and distribution costs; however, the amount of distribution costs to include in an impairment model may vary depending on the facts and circumstances.
- A discounted cash flow analysis should include all relevant taxation effects that would influence the price a market participant would pay for a film.
- An impairment should be recorded if the fair value of a film is below the unamortized film costs, even if a specific impairment trigger cannot be identified.
- The discount rate applied to net cash flows should reflect the time value of money, the potential for variations in the amount and timing of cash flows, and the return market participants would seek from that particular film.
- ASU 2012-07[1] amended the guidance in ASC 926[2] on impairment assessments of unamortized film costs by limiting the inclusion of subsequent events to a fair value measurement only if market participants would also have considered those events as of the measurement date.

The uncertainties associated with a film's success can result in various challenges related to the testing of unamortized film costs for impairment.

[1] FASB Accounting Standards Update No. 2012-07, *Accounting for Fair Value Information That Arises After the Measurement Date and Its Inclusion in the Impairment Analysis of Unamortized Film Costs* — a consensus of the FASB Emerging Issues Task Force.

[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification.*"

Beyond the Bottom Line

This *Media & Entertainment Spotlight* discusses the challenges film production entities face when performing an impairment analysis on unamortized film costs.

Background

Various risks and uncertainties influence the ability of a film production entity to produce a commercially successful film in today's environment. These uncertainties may call into question a film's fair value and the potential need for an impairment of any unamortized film costs capitalized during a film's production. The determination of a film's fair value largely depends on the extent of its success. In performing this assessment, film production entities may need to exercise significant judgment in determining a range of assumptions and estimates that are often based on limited information. Although these estimates can be refined as a film nears completion, market reaction and the extent of a film's success will not be fully known until after its actual release.

These uncertainties result in various challenges related to the determination of the fair value of a film for impairment purposes and in certain instances may result in diversity in practice as film production entities develop and apply impairment models to suit their own specific circumstances. Given these challenges, this *Media & Entertainment Spotlight* provides an overview of the U.S. GAAP requirements related to assessing impairment of unamortized film costs, including the complications entities may face in the practical application of such guidance.

When the fair value of a film is less than the unamortized film costs related to that film, a film producer should write off the amount by which the unamortized film costs exceed the film's fair value.

Key Accounting Issues

Discussed below are the key accounting issues associated with performing an impairment test on unamortized film costs. The discussion explores recent amendments to film impairment guidance made by ASU 2012-07 as well as broader issues associated with applying existing GAAP to determine the fair value of a single film. It is not meant to address situations in which a film library is acquired as part of a business combination or the relevant issues associated with a television series; different factors may need to be considered in those situations.

Recent Amendments to Film Impairment Guidance — ASU 2012-07

ASC 926 requires that film costs be capitalized while a film is under production. However, it also requires that when the fair value of a film is less than the unamortized film costs related to that film, a film producer should write off the amount by which the unamortized film costs exceed the film's fair value.

Before ASU 2012-07, ASC 926 stated the following regarding a film's fair value:

> 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 the financial statements are issued or are available to be issued, . . . 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 shall adjust its financial statements for the effect of any changes in estimates resulting from the use of the subsequent evidence.

Therefore, there was a rebuttable presumption that when performing an impairment analysis on unamortized film costs, film producers were required to incorporate subsequent events (e.g., poor box office performance for a film released after period-end) into the fair value calculation as of the measurement date (e.g., period-end). Although it was permitted, overcoming this presumption was difficult in practice.

This rebuttable presumption contradicted ASC 820, which requires entities to base their fair value determination on the assumptions and estimates market participants would have considered as of the measurement date. As a result, ASU 2012-07 eliminated the rebuttable presumption that events arising after the measurement date were deemed to exist as of that measurement date and should be incorporated into an impairment calculation as of that date. Consequently, the ASU requires entities to incorporate the effects of such events into an impairment analysis only if market participants would have considered such information as of the measurement date.

Although the removal of this presumption allows entities to avoid having to *automatically* incorporate evidence that arose after the measurement date into their impairment calculation, entities should nevertheless carefully consider subsequent events and conditions to determine whether they reflect information and assumptions that market participants would have considered as of the measurement date. Further, even if it is determined that evidence that arose after the measurement date need not be included in the impairment test, disclosure may still be necessary under ASC 855.

ASU 2012-07 eliminated the rebuttable presumption that events arising after the measurement date were deemed to exist as of the measurement date.

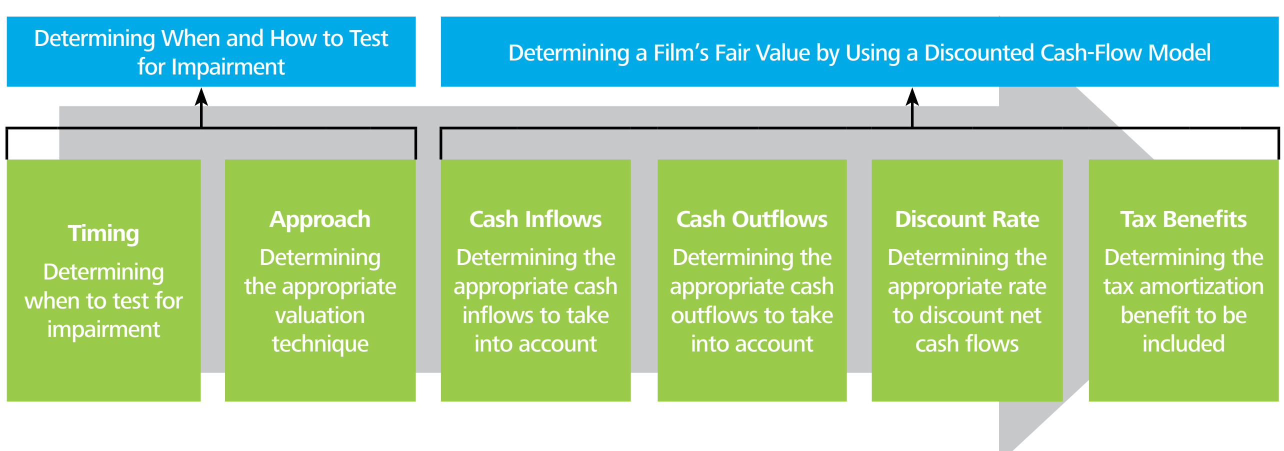
Example

Entity A releases a film on the last day of its 20X2 fiscal year-end, and the film generates significantly lower box office sales than expected between the balance sheet date (measurement date) and the date on which the financial statements are authorized to be issued.

Before ASU 2012-07, the existing rebuttable presumption in ASC 926 would have required Entity A to incorporate the lower box office sales into the impairment test as of the balance sheet date, which would most likely have resulted in an impairment of the unamortized costs related to that film in the 20X2 financial statements. After ASU 2012-07, actual box office performance would only be taken into consideration if market participants would have expected poor performance as of the measurement date.

Film Impairment Considerations

The broader topic of fair value in ASC 820 remains complex, particularly in the film industry, in which an individual film's financial outcome is historically difficult to predict. In simple terms, unamortized film costs should not exceed a film's fair value. The difficulties associated with film impairment testing include the determination of when and how to test for impairment and the subsequent assessment of a film's fair value, which involve a number of individual steps, each with its own challenges. The following diagram illustrates the broad steps in this process:



The challenges associated with each of these steps are highlighted below.

Timing

The first step in the impairment process is to determine when an entity should perform an impairment test of unamortized film costs. ASC 926-20-35-12 states:

> Unamortized film costs shall be tested for impairment whenever events or changes in circumstances indicate that the fair value of the film may be less than its unamortized costs.

ASC 926-20-35-12 illustrates the types of events that may trigger an impairment test, such as delays in release schedules or situations in which actual costs substantially exceed budgeted costs. However, this list is not exhaustive and film producers should monitor events in addition to those listed in ASC 926 for impairment indicators and should perform an impairment test whenever the fair value of a film may be below its cost.

In certain instances, a film producer may have concluded that the fair value of a film is below the unamortized film costs but may be unable to identify an impairment indicator (i.e., trigger) that would explain the apparent impairment, thus causing the film producer to question the need to record an impairment. ASC 926 requires that an impairment be recorded in all instances in which the fair value of a film is below the unamortized film costs, even if a specific trigger has not been identified.

ASC 926 requires that an impairment be recorded in all instances in which the fair value of a film is less than the unamortized film costs, even if a specific trigger has not been identified.

Example

Entity XYZ has capitalized $7 million in costs related to a film expected to be released in the next month and has recently updated its cash flow projections in connection with the film. The undiscounted net cash flows expected to be realized from the film are $8 million; however, once discounted at the appropriate rate, the fair value of the film is estimated to be $6 million. Entity XYZ has not identified any of the events or conditions listed in ASC 926-20-35-12.

Under ASC 926, Entity XYZ would need to record an impairment of $1 million given the conclusion that the fair value of the film is estimated to be $6 million, regardless of whether the impairment is supported by a specific management-identified trigger.

Film Life Cycle and Its Influence on Timing of Impairment Testing

During the early stages of a film's production, market success is difficult to estimate because of the lack of reliable information about expected cash flows. As a result, impairment indicators may not be present or may be difficult to identify. In practice, indicators are primarily identified as the film nears completion or when the film is completed but not yet released. At or near the completion of a film, a film producer is better able to determine how specific test audiences or other potential markets are responding to the film, often by using "film tracking" information. As the release date approaches, this type of information is considered more relevant and reliable in the assessment of whether a potential write-down of unamortized film costs is warranted.

Although impairment considerations are typically identified at or near the completion of a film, producers are encouraged to closely monitor all developments that occur throughout a film's life cycle to ensure that impairment tests are performed at the appropriate times. In some cases, film impairments may need to be recorded before a film's completion.

Approaches for Determining a Film's Fair Value

Cost and Income (Discounted Cash Flow) Approaches

ASC 926-20-35-14 states that "a discounted cash flows model is often used to estimate fair value." ASC 926 does not discuss alternative approaches to determining the fair value of a film. Because the information available during the production period is significantly less reliable than the information available upon completion or release, producers generally employ two different approaches when determining the film's fair value: a cost approach and an income approach.

A **cost approach** is typically most appropriate when a film is still in production because the fair value of the film approximates the capitalized costs to date.

Most film producers will inherently apply a cost approach until a film is in postproduction or is complete. Triggering events or changes in circumstances that would indicate an impairment of unamortized film costs are typically not expected during the production phase. As a film nears completion and the film's performance can be more accurately predicted, a shift from the cost approach to an income approach (i.e., a discounted cash flow model) will generally be warranted.

The discounted cash flow model is the predominant valuation technique used to determine the fair value of a film if an impairment indicator is identified on or near its release date.

The **discounted cash flow model** is the predominant valuation technique used to determine the fair value of a film if an impairment indicator is identified on or near the film's release date, which is generally the point at which reliable cash flow predictions can be made on the basis of current market conditions.

ASC 926 requires that fair value be determined in accordance with ASC 820, which describes fair value as "the price that would be received to sell an asset . . . in an orderly transaction between market participants at the measurement date."

It is acceptable to use the discounted cash flow model to measure fair value under ASC 820. The inputs to the discounted cash flow should be determined from the perspective of a market participant. Because the price represents the fair value under ASC 820, all inputs to the model should be determined as if the film was sold to a market participant.

Net Realizable Value

Before the guidance in ASC 926 (formerly SOP 00-2[3]) was developed, entities were required to apply a net realizable value (NRV) impairment model in accordance with Statement 53.[4] Statement 53 did not require entities to discount cash flows to determine an impairment; rather, it simply stated that "if estimated future gross revenues from a film are not sufficient to recover the unamortized film costs, other direct distribution expenses, and participations, the unamortized film costs shall be written down to net realizable value."

SOP 00-2 (now ASC 926) superseded this guidance and replaced the NRV model under Statement 53 with the fair value model. The rationale for this change was that an entity would seldom measure for impairment if it compared undiscounted estimated cash flows with unamortized film costs and, therefore, a discounted cash flow model was considered preferable.

Determining Cash Inflows

Under the discounted cash flow model, the first step is to determine the appropriate revenues or inflows to include. ASC 926-20-35-14 states:

> 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 paragraphs 926-20-35-5 and 926-20-35-11, shall be included.

[3] AICPA Statement of Position 00-2, *Accounting by Producers or Distributors of Films* (codified in ASC 926).
[4] FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films.*

Revenues typically include domestic and foreign income from box office or theatrical sales, video sales, merchandise, pay television, or pay-per-view as well as fees from broadcast licenses with networks and syndication arrangements.

The limitations to revenue described in ASC 926-20-35-5 and ASC 926-20-35-11 refer to the ultimate revenues included in the calculation of the *amortization* of capitalized film costs under the individual-film-forecast-computation method. Such limitations include those related to the number of periods over which revenues can be forecasted as well as the potential exclusion of revenues from certain markets or products without sufficient persuasive evidence or history indicating that such revenue will be realized.

For impairment testing purposes, the limitations in ASC 926-20-35-5 and ASC 926-20-35-11 do not apply in the calculation of fair value under ASC 820. As previously noted, ASC 820 requires a market-participant perspective (i.e., if a market participant would be expected to include certain inflows, such inflows should be included in an impairment model). However, to avoid overstating the fair value of a film, an entity should be careful not to include sources of revenue that would not be considered by a market participant.

Determining Cash Outflows

ASC 926-35-20-15 states:

> 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 shall 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.

Entities incur a number of costs to produce and distribute filmed content, including the direct costs of production, interest, marketing, advertising and other exploitation costs, distribution expenses, and taxes. Direct costs of production and interest are capitalized under ASC 926 and are subject to impairment testing. Other costs, such as those related to distribution and advertising, are generally not capitalized but are necessary cash outflows to exploit the film content and realize the inflows from the film after it has been completed. Because such noncapitalizable costs are necessary to generate revenues, these cash outflows are also included in an impairment analysis under the discounted cash flow model.

Participations and residuals often make up a significant cash outflow. Determining how to include the actual cash outflows in the model can be difficult because such costs generally consist of different calculations and payments. For expediency, participations and outflows of residuals are often captured as a percentage applied to current-period revenue. When included as a percentage of revenue, the outflow is considered "disbursed" in the same period as that in which the inflows are received. This approximation is typically considered conservative, since the most significant participation payments are generally disbursed only after a film becomes cash-flow-positive.

Exploitation Costs

Exploitation costs are defined in the ASC Master Glossary as all "direct costs (including marketing, advertising, publicity, promotion, and other distribution expenses) incurred in connection with the distribution of a film." As the name implies, exploitation costs are all costs related to delivery of a completed film into a market, including the film's marketing and promotion. Each type of cost is critical to the film's ultimate success, and costs can be individually significant. In particular, advertising and other marketing-related expenditures are generally front-loaded and constitute a large proportion of cash outflows in the periods immediately before and after a film's release.

Exploitation costs are all costs related to delivery of a completed film into a market, including the film's marketing and promotion.

In addition to their critical role in sparking public interest in a film and helping ensure a successful release, advertising and promotion-related expenditures are important from a valuation perspective because every dollar spent on advertising immediately before a film's release is excluded from the future projected outflows in the impairment model. Significant expenditures on advertising and other promotional costs immediately before a film's release therefore may enhance the film's fair value and could cause a film to avoid an impairment charge if the same impairment model is applied after a film's release.

Example

Entity P has $6 million of unamortized film costs capitalized as of October 31, 20X2, in connection with a new film released on October 15, 20X2. Before the film's release, P had already incurred $4 million of exploitation costs, which was the vast majority of the anticipated advertising and promotional expenditures expected to be incurred on marketing the film. In addition, P had originally expected to generate cash inflows of $20 million from the film's release. However, by October 31, 20X2, the film is performing more poorly than projected and is now only expected to generate $7 million. As a result of this information, P is currently performing an impairment test on the unamortized film costs as of October 31, 20X2. In this example, discounting is ignored and there are no outflows other than the exploitation costs described.

In determining the inputs to the discounted cash flow model, P revises its total cash inflow estimate to $7 million; however, since it had incurred virtually all its exploitation costs before the film's release date, the projected cash outflows related to the film's exploitation in the years to come are insignificant. Because P incurred the exploitation costs before the film's release and consequently reduced the cash outflows necessary to generate the film's cash inflows, P concludes that the film is not impaired despite its anticipated poor performance. This conclusion may have been different if P expected to incur much of its exploitation expenditure after October 31, 20X2, and therefore would have projected a lower "net" cash flow.

When entities determine the fair value of a film, a difference in distribution costs can result.

Distribution of a film to the various markets in which it is exploited is also key to achieving a film's expected cash inflows. Given the volume and frequency of films they release, some studios have in-house distribution departments. By contrast, other film producers may need to outsource distribution of their films to third parties (typically the major studios). When entities determine the fair value of a film, a difference in distribution costs can result, depending on which of the following alternatives is considered to be a "market participant" perspective:

- *In-house distribution: incremental rate* — In-house distribution departments typically are dedicated to distributing a certain number of films each year and therefore view the incremental cost of distributing one film as the market-participant assumption. As a result, under this method, only the expected incremental variable costs are considered part of a film's exploitation costs. Such costs are generally minimal.
- *In-house distribution: average rate* — Under this alternative, the total annual costs of a distribution department are divided by the expected number of films distributed per year, yielding the average distribution rate per film.
- *Outsourced distribution rate* — Under this alternative, the film is considered to be distributed by an independent party. Supporters of this view refer to the distribution rates charged to independent film producers and film financing partners, which typically incur larger costs for distribution. The main difference between this view and the "in-house distribution: average-rate" view described above is that a profit margin is included under the "outsourced distribution rate" view.

A film producer should exercise careful, well-documented judgment in determining the most appropriate distribution rate assumption (and its related cost structure) that would be available to a market participant wishing to exploit the benefits of a film. The distribution rate may also vary over the life cycle of a film. Cash inflows expected during a film's early stages are generally much more substantial than those expected in a film's latter stages. Accordingly, the distribution rate (i.e., distribution costs expressed as a percentage of expected revenue) for a recently released film would be expected to be lower than the distribution rate for a film that has passed the theatrical window.

Income Taxes

As mentioned above, to realize the net cash flows, an entity should consider all cash outflows in calculating fair value under the discounted cash flow approach. One such cash outflow is related to the payment of income taxes by the owner of a film. The price expected to be received from the sale of a film to a market participant is influenced or altered by the relevant taxation effects expected by any market participant that owns the film; thus, a discounted cash flow model should include expected income tax outflows in the determination of a film's fair value.

Under ASC 820-10-35-3, fair value is determined on the basis of the price the entity would receive upon sale to a market participant. The price a market participant would pay is influenced by what the participant expects to realize from the film (adjusted for uncertainties and the time value of money). Consequently, in assessing fair value, an entity should consider the taxation effects a willing buyer would factor into the price it would be prepared to pay. Entities should use appropriate market-participant tax rates to estimate the expected income tax payments.

In addition, as part of a fair value assessment, film producers would need to consider any potential tax deductions a willing buyer would be eligible to take by purchasing a film (see discussion in the Tax Amortization Benefits section below).

A discounted cash flow model should include expected income tax outflows in the determination of a film's fair value.

Discount Rate

ASC 926-20-35-17 states:

> When determining the fair value of a film using a traditional discounted cash flow approach, the discount rate(s) shall not be an entity's incremental borrowing rate(s), liability settlement rate(s), or weighted average cost of capital because those rates typically do not reflect the risks associated with a particular film. The discount rate(s) shall 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.

Under the NRV model in Statement 53, an entity was not required to discount net cash flows in determining fair value. ASC 926 and ASC 820, however, require such discounting. The discount rate applied is an important assumption in a discounted cash flow model because it can significantly influence the fair value of a film and the ultimate impairment. The rate selected for the impairment test should reflect not only the time value of money but also the potential for variations in the amount and timing of cash flows as well as other risks market participants would perceive in the cash flows.

Discount rates may change over the life cycle of the film. In practice, discount rates are typically higher before a film's release, largely because the rates are influenced by the inherent uncertainties associated with the film's ultimate success and by the ability of entities to accurately forecast the cash flows involved. Once a film has been released, the risk factor applied to the discount rate decreases, which generally results in a lower discount rate because cash flow predictions are much more reliable and accurate at that point.

Example

Film Producer Y approves the production of a film adapted from a successful book whose content is considered controversial. During production, additional concerns are raised about the breadth of the audience expected to watch the film. As a result, Y performs an impairment test and uses a discount rate of 16 percent to reflect a market participant's expectations about potential variability in cash flows and the rate market participants would seek for bearing the risks inherent in this production.

After the film is released, Y updates its discounted cash flow model. Because Y has more reliable cash flow estimates as a result of the box office performance, Y applies an 8 percent discount rate to the discounted cash flow model. The decrease in discount rate reflects a reduction in the uncertainty market participants would place on projections.

Tax Amortization Benefits

As mentioned in the Income Taxes section above, the fair value of a film is affected by any potential tax amortization benefits that may be obtained by a purchaser of a film if the film were sold to the purchaser by the film producer in accordance with ASC 820-10-35-3. Because a film purchaser can deduct the amount paid (i.e., its tax basis), there is inherent value in the film; therefore, from a valuation perspective, this tax benefit should form part of the film's fair value.

The fair value of a film is affected by any potential tax amortization benefits that may be obtained by a purchaser of a film.

This guidance on tax amortization benefits is consistent with that in paragraph 129 of FASB Statement 109,[5] which notes that the amounts assigned to the fair value of assets should not be net of any related deferred tax liability or asset. It is also consistent with the guidance in Chapter 5 of the AICPA practice aid on assets acquired in a business combination to be used in research and development,[6] which contains helpful examples.

Tax amortization benefits generally apply to any fair value measurement of nonfinancial assets and is not limited to the application of fair value in a business combination.

The value of the tax amortization benefit to be included in a film's fair value measurement will largely be determined on the basis of the relevant tax law governing the deduction of a film's tax basis. Sections 167 and 197 of the Internal Revenue Code (IRC) apply to the depreciation and amortization deductions of a film's tax basis for U.S. entities as follows:

- Section 167 applies to film costs that are capitalized as part of a single film production. It permits an entity to deduct capitalized costs under the "income forecast" method, which is largely in line with book amortization under ASC 926. The income forecast method matches the recognition of income with the associated capitalized costs, thus resulting in accelerated amortization since the revenues for films are generally front-loaded.
- Section 197 permits a deduction on a straight-line basis over a 15-year period and is applicable when films are acquired as part of a broader acquisition transaction (e.g., the purchase of an entity or studio that owns several films that are currently being exploited). This method is generally considered less advantageous than the Section 167 deduction given (1) its straight-line amortization pattern and (2) that films earn the large majority of their revenues in the first few years after release. Therefore, under this method, an entity would pay more taxes (as a result of lower deductions) earlier in the film's life cycle and fewer taxes in the years after the film's release.

[5] FASB Statement No. 109, *Accounting for Income Taxes* (codified in ASC 740).

[6] AICPA Practice Aid, *Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices, and Pharmaceutical Industries.*

An entity’s use of IRC Section 167 or 197 in determining the fair value of a tax amortization benefit depends on many factors. Entities are encouraged to consult with a qualified professional adviser on this topic before determining the tax amortization benefit to use in an impairment analysis.

Unamortized Film Cost Impairment Test

The following example illustrates several of the challenges associated with performing an impairment test:

Example

Movie Maker (MM) is an independent film studio that produces a limited number of films each year. Its most recent production is the drama *At Risk*. From its inception, MM had high expectations that the film would be a domestic and international success. Filming commenced on July 1, 20X2, and was completed on October 31, 20X2. Postproduction was completed on November 28, 20X2, and the movie is currently scheduled for release on February 12, 20X3. MM has a December year-end, and is preparing its December 31, 20X2, financial statements.

As of December 31, 20X2, MM had capitalized $13.150 million in direct film costs incurred during the production period. Up until October 31, 20X2, MM had strong expectations that *At Risk* would be a success but could not estimate the anticipated cash flows with sufficient reliability to justify the use of a discounted cash flow model. In addition, MM did not test for impairment because there were no events triggering such a test or indicators that it should do so. In December 20X2, MM determined that the response to the film was less favorable than anticipated and MM reassessed its expectations. In an effort to improve the film, MM decided to push back the release date by two months (to April 12, 20X3) to reshoot certain scenes and possibly change the film’s ending, which received particularly negative reviews.

MM concluded that a triggering event existed at period-end and that a fair value determination was therefore required. In addition, MM concluded that a discounted cash flow model is the most appropriate method to determine fair value.

The following table shows MM’s impairment analysis and major assumptions:

Fair Value — *At Risk* (Values in 000s)

Inflows	% of Revenue	Ult. Rev to Come	20X3	20X4	20X5	20X6	20X7	20X8	20X9	20X10	20X11	20X12	20X13	Terminal Value
Theatrical		12,200	11,150	1,050	—	—		—	—	—	—	—	—	
Video		11,790	6,500	3,500	700	200	200	150	150	125	115	85	65	
Pay TV		4,600	2,500	2,000	100	—	—	—	—	—	—	—	—	
Network		2,310	—	—	1,000	700	250	100	100	—	—	—	—	
Syndication		4,430	—	—	100	1,800	1,050	700	300	200	100	100	80	
Merchandising		570	350	150	60	10	—	—	—	—	—	—	—	
Total Revenues		35,900	20,500	6,700	1,960	2,710	1,350	950	550	405	295	185	145	
Outflows														
Participations	3.5%	1,263	718	235	69	95	53	34	20	15	11	7	6	
Residuals	4.5%	1,621	923	302	88	122	68	43	25	19	14	9	7	
Prints		480	350	130	—	—	—	—	—	—	—	—	—	
Advertising		4,995	3,000	1,050	300	300	500	90	40	25	15	15	10	
Video Costs		2,005	1,100	200	150	125	120	120	80	50	30	15	15	
Distribution	8.0%	2,874	1,640	536	157	217	120	76	44	33	24	15	12	
Merchandising		285	175	75	30	5	—	—	—	—	—	—	—	
Total Costs		13,523	7,906	2,528	795	864	511	363	209	142	94	61	50	
Net Cash Flows		22,377	12,594	4,172	1,165	1,846	989	587	341	263	201	124	95	
Income Taxes (40%)		8,955	5,038	1,669	466	739	396	235	137	106	81	50	38	
Available Cash Flows (Incl. Terminal)		13,802	7,556	2,503	699	1,107	593	352	204	157	120	74	57	380

	Discount Rate	Total
Total Present Value	15%	10,266
Add: Tax Amortization Benefit		2,567
Estimated Fair Value of *At Risk*		12,833
Unamortized Film Costs		13,150
Impairment		(317)

Cash Inflows

MM expects that the film will generate the majority of its income over the next 10 years and that it will thereafter earn relatively minor income in perpetuity.
MM has adjusted its potential cash inflows to account for the anticipated lower level of success in certain categories or sources of income. However, MM still expects (1) a reasonable level of theatrical income after making its planned changes to the film, (2) better success in video and pay TV after a steady level of domestic and international market exposure, and (3) network and syndication income in years to come. (See the Determining Cash Inflows section above for more information.)

Cash Outflows

Cash outflows include a participation agreement with the lead actor that provides for an overall participation fee of 3.5 percent of revenue. Residuals amounting to 4.5 percent of revenue are also included. Other expenditures include the cost of producing prints of the film, video costs, merchandising, and advertising, the majority of which occur in the year of release.

The fee for distribution services is estimated to be approximately 8 percent of expected revenues. Management believes that this value accurately reflects what an average market participant would have to incur to distribute the film. (See the Determining Cash Outflows section above for more information.)

Income Taxes

Income taxes are deducted from net cash flows at the appropriate rate of 40 percent in the determination of total available cash flows from the film.

Terminal Value

Total available cash flows also include the film's terminal value, which equates to the present value of the cash flows expected to be realized in perpetuity.

Discount Rate

A discount rate of 15 percent has been applied to the available cash flows and reflects not only the time value of money but also the possibility of variations in the amount and timing of the expected cash flows as well as an element to reflect the price market participants would seek for bearing the uncertainty inherent in the film. (See the Discount Rates section above for more information.)

Tax Amortization Benefit

Included in the fair value of *At Risk* is the tax amortization benefit associated with transferring the film to a market participant. (See the Tax Amortization Benefits section above for further details.)

Conclusion

The fair value of *At Risk* is estimated to be $12.833 million, which is below the capitalized costs of $13.150 million. Thus, an impairment charge of $317,000 should be recorded through profit or loss in MM's December 20X2 financial statements.

Challenges

Use of Judgment

The impairment test for unamortized film costs can be subjective and complex, and each step requires film producers to exercise judgment in applying the impairment guidance in ASC 926. These judgments may significantly affect any conclusions drawn and entities should consider implementing the appropriate processes and controls to minimize the associated risks. In addition, after the introduction of ASU 2012-07, film producers valuing a film may be required to exercise additional judgment in determining whether an event that occurs after the measurement date, but before the financial statements are issued, should be included in a film's fair value calculation as of the measurement date (as opposed to automatically incorporating it under the rebuttable presumption in ASC 926 that existed before the amendments in ASU 2012-07).

Materiality

Questions about the role of materiality often arise in an impairment analysis of unamortized film costs. Materiality is an inherent consideration in financial reporting, since management should ensure that the financial statements are not materially misstated and that they accurately and fairly present an entity's results of operations and financial position. Entities may determine that the use of different judgments is not significant in a film impairment test. However, they will need to assess the specific facts and circumstances of each situation before treating any differences in judgments as immaterial.

Thinking Ahead

Film producers are encouraged to continually review their impairment models as well as any assumptions or judgments to ensure that they accurately reflect the requirements of U.S. GAAP, existing market conditions, and the facts and circumstances associated with each film they produce. Entities should also note that the amendments under ASU 2012-07 apply to impairment assessments performed on or after December 15, 2012, by public companies and on or after December 15, 2013, by nonpublic companies. Entities not already applying such amendments should consider the potential effects on their own impairment models, processes, and controls and should develop a plan to implement any necessary changes.

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