March 13, 2012

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Revised Exposure Draft – Revenue from Contracts with Customers
(File Reference No. 2011-230)

Dear Technical Director:

The Walt Disney Company is pleased to have the opportunity to comment on the revised exposure draft, Revenue from Contracts with Customers (ED). While we are supportive of the goal of a single, comprehensive revenue recognition model, we recommend the Board reconsider or clarify certain aspects of the ED which we believe may lead to diversity in practice and drive additional administrative costs. Our primary concerns include the following:

Pattern of Revenue Recognition for Multi-Year Intellectual Property License (IPL) Arrangements

Because of a number of characteristics of IPL arrangements in our industry (i.e. film and television entertainment and related character-based licensing), such as implicit and explicit licensor-imposed restrictions during the license term, we believe the continuous transfer of control model of revenue recognition would better reflect the economics of these transactions than the point in time model specified in the ED.

Non-Cash Consideration to Be Resold

In our industry, it is common to provide our film and television IP to television distributors in exchange for broadcast air time that we sell to advertisers. Currently, revenue is generally only recorded in connection with sales to advertisers. The ED seems to suggest that two revenue transactions would be recorded in these situations. We believe the Board should clarify the intent of the ED in these circumstances.

Onerous Performance Obligations

We believe the Board should clarify the application of the onerous performance obligation provisions of the ED to situations when the costs to satisfy a performance obligation are recovered from multiple contracts or revenue streams.
Transition

Rather than requiring retrospective application in the primary financial statements, we believe the Board should provide a principle-based approach to transition that simply requires preparers to provide information that would allow users to reasonably understand the impact of the new rules. Depending on the significance and complexity of the changes on any particular company, preparers might choose to provide full retrospective application, pro forma information in the footnotes or just qualitative discussion.

The following paragraphs provide more detailed discussion and examples of these issues.

Pattern of Revenue Recognition for Multi-Year IPL Arrangements

Under the ED, IPL revenue is generally recognized at the beginning of the license period because that is deemed to be the point at which control transfers; however, we believe IPL arrangements generally result in a continuous transfer of control. For example, in many arrangements in our industry there are on-going licensor-imposed restrictions such as interruptions in the ability of the licensee to use the IP during the license term or limitations on the frequency and timing of the use of the IP. We believe these restrictions make it difficult to assert that control has fully transferred on the first day of the license term. The most effective way to ensure that IPL revenues, particularly in our industry, are accounted for on a consistent basis across companies and arrangements is to recognize revenue on the basis that control transfers over the term of the license arrangement.

An example of the type of restriction that may be unique to IP licensing in our industry is a situation in which the licensee pays a fixed fee to obtain the right to exploit a film only once per year over a two-year period. In such situations, it is unclear whether transfer of control for the second year of exploitation occurs at the beginning of the arrangement or at the point in time when the restriction is lifted (i.e. the first day of the second year). As another example, the licensor of an episodic television series may require that the episodes be aired in a particular order over a specified time frame such that the licensor can insert advertisements into the broadcast signal. The subjective interpretation and application of the notion of transfer of control for arrangements with licensor-imposed restrictions may drive inconsistent outcomes across companies with similar arrangements.

In addition, in film, television, and character-based licenses, the underlying asset (i.e. the IP or right to use the IP) typically reverts back to the licensor with substantial economic value remaining. The ED acknowledges that when a contract includes an unconditional obligation (forward) or an unconditional right (call option) for the seller to repurchase the underlying asset, the customer does not obtain control of the asset because “the customer is limited in its ability to direct the use of and obtain substantially all of the remaining benefits from the asset” [emphasis added]. In situations where the licensor retains significant risks and rewards related to the licensed IP through a reversionary interest, a revenue recognition pattern over the license term more appropriately reflects the economics of the transaction as
the licensor is granting the “right to use” the asset over the license term. We recommend that the Board consider whether the provisions of the ED related to forwards and call options should be adapted to cover IPL arrangements.

Noncash Consideration To Be Resold

We believe the Board should clarify whether the ED intended to result in a gross-up of revenue related to arrangements which include noncash consideration that will ultimately be resold to a third party. As an example, in a barter advertising arrangement, a television network enters into an affiliation agreement to provide the network’s programming to a local TV station in exchange for the network being able to sell advertising time to third-party advertisers during the broadcast. It appears that under the ED, the network would record two revenue transactions: one upon providing the network programming to the TV station in exchange for the advertising time (recording an asset for the value of the advertising time) and the other with respect to the sale of the advertising time to an advertiser. In this situation, it is unclear whether the asset created in the first revenue transaction is cleared against the revenue from the second revenue transaction or against cost of goods sold. If the latter, this would create a significant gross-up of revenue relative to current practice. If this is not the intent, the Board might consider including a provision in the ED that would require net reporting for these types of transactions (i.e. those where non-cash consideration is received and resold in a similar line of business).

Onerous Performance Obligations

We believe the application of the onerous performance obligation test in the ED needs further clarification. We are unsure of the proper application of the test in situations when a pool of costs, both current and future, are recovered from more than one customer contract and/or from multiple revenue streams. As an example, our cable networks provide programming services under long term agreements with multiple cable distributors (with different expiration dates). These contracts are generally serviced from an aggregate pool of costs, and these costs are also recovered from advertising revenue arrangements with numerous third party advertisers. Given this complexity, we believe that the application of the onerous performance obligation provisions of the ED to these types of arrangements could lead to significant diversity in practice. For instance, exclusion of advertising revenues from the evaluation may result in the treatment of each distribution arrangement as onerous when the overall network is profitable. Depending on the method used, the allocation of programming costs across distribution arrangements could produce similar outcomes. We suggest that the Board provide an example in a final standard that would show how this type of analysis might be performed. We also recommend that the Board consider providing a principle-based approach that would allow companies to evaluate potentially onerous contracts in the context of the overall profitability of a business. As an example, the ED could provide qualitative indicators to identify when the onerous test should be applied to individual performance obligations.

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We appreciate the Board’s outreach efforts with constituents in a number of industries to gain a more detailed understanding of the potential effects of the ED. Due to the significant administrative costs, potential changes to reported financial statements and supporting systems, and complexity in applying this model, we urge the Board to set an effective date that provides sufficient time for companies to adopt the new rules in an organized and systematic way.

We would be pleased to respond to questions regarding our comments in this letter as well as other aspects of the ED.

Sincerely,

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