

Statement of Financial Accounting Standards No. 50

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Financial Reporting in the Record and Music Industry

November 1981



Financial Accounting Standards Board
of the Financial Accounting Foundation
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FAS 50: Financial Reporting in the Record and Music Industry

FAS 50 Summary

This Statement extracts the specialized accounting principles and practices from AICPA Statement of Position 76-1, *Accounting Practices in the Record and Music Industry*, and establishes standards of financial accounting and reporting for licensors and licensees in the record and music industry. If a license agreement is, in substance, an outright sale and collectibility of the licensing fee is reasonably assured, this Statement requires the licensor to recognize the licensing fee as revenue. This Statement requires a licensee to record minimum guarantees as assets and charge them to expense in accordance with the terms of the license agreement. It also establishes accounting standards for artist compensation cost and cost of record masters.

INTRODUCTION AND BACKGROUND INFORMATION

1. As discussed in FASB Statement No. 32, *Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters*, the FASB is extracting the specialized¹ accounting and reporting principles and practices from AICPA Statements of Position (SOPs) and Guides on accounting and auditing matters and issuing them in FASB Statements after appropriate due process. This Statement extracts the specialized principles and practices from SOP 76-1, *Accounting Practices in the Record and Music Industry*, and establishes financial accounting and reporting standards for the industry.

2. The Board has not undertaken a comprehensive reconsideration of the accounting issues discussed in SOP 76-1 and has extracted the specialized accounting and reporting principles without significant change. Accordingly, some of the background material, discussion of accounting alternatives, and general accounting guidance have not been carried forward from the SOP. The Board's conceptual framework project on accounting recognition criteria will address revenue recognition issues that may pertain to those addressed in this Statement. A Statement of Financial Accounting Concepts resulting from that project in due course will serve as a basis for evaluating existing standards and practices. Accordingly, the Board may wish to evaluate the standards in this Statement when its conceptual framework project is completed.

3. SOP 76-1 was developed to clarify and standardize accounting by the record and music industry, particularly when manufacturers and distributors should recognize revenue from sales. Before 1976,

manufacturers and distributors usually recorded sales when inventory was shipped in accordance with normal trade terms and, because of the return or exchange privileges that characterized the industry, usually provided for the anticipated return of records from current and prior sales. The SOP notes that manufacturers and distributors in the record and music industry must be able to make a reasonable estimate of returns to account for shipments to customers as sales. The SOP also presents conclusions about the accounting by music publishers and other licensors when music copyrights or **record masters**² are licensed, for compensation to recording artists in the form of **royalties**, and for costs of record masters and about the accounting by licensees for various fees.

4. An Exposure Draft of a proposed Statement, *Financial Accounting and Reporting in the Record and Music Industry*, was issued June 12, 1981. The Board received 12 comment letters in response to the Exposure Draft. Several respondents suggested minor clarifications that were adopted. No substantive changes were made.

5. The conclusions in SOP 76-1 regarding recognition of sales revenue when right of return exists are based upon SOP 75-1, *Revenue Recognition When Right of Return Exists*. The FASB has issued FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*, that extracts the specialized principles from SOP 75-1. Because the principles for revenue recognition when right of return exists are not unique to the record and music industry, this Statement does not address that subject.

6. The Board has concluded that it can reach an informed decision on the basis of existing information without a public hearing and that the effective date and transition specified in paragraph 17 are advisable in the circumstances.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Licensor Accounting

Revenues

7. Substantial revenues may be realized by the owner of a record master or music copyright by entering into **license agreements**. A license agreement may be, in substance, an outright sale. If the licensor has signed a noncancelable contract, has agreed to a fixed fee, has delivered the rights to the licensee who is free to exercise them, and has no remaining significant obligations to furnish music or records, the earnings process is complete and the licensing fee shall be reported as revenue if collectibility of the full fee is reasonably assured.

8. A **minimum guarantee** may be paid in advance by a licensee. The licensor shall report such a minimum guarantee as a liability initially and recognize the guarantee as revenue as the license fee is earned under the agreement. If the licensor cannot otherwise determine the amount of the license fee earned, the guarantee shall be recognized as revenue equally over the remaining performance period, which is generally the period covered

by the license agreement.

9. Other fees (for example, for free records distributed by a record club in excess of a stipulated number) also may be required under the license agreement. Such other fees that are not fixed in amount prior to the expiration date of the agreement shall be recognized as revenue by the licensor only when reasonable estimates of such amounts can be made or the agreement has expired.

Artist Compensation Cost

10. The amount of royalties earned by artists, as adjusted for anticipated returns, shall be charged to expense of the period in which the sale of the record takes place. An **advance royalty** paid to an artist shall be reported as an asset if the past performance and current popularity of the artist to whom the advance is made provide a sound basis for estimating that the amount of the advance will be recoverable from future royalties to be earned by the artist. Advances shall be charged to expense as subsequent royalties are earned by the artist. Any portion of advances that subsequently appear not to be fully recoverable from future royalties to be earned by the artist shall be charged to expense during the period in which the loss becomes evident. Advance royalties shall be classified as current and noncurrent assets, as appropriate.

Cost of Record Masters

11. The portion of the cost of a record master borne by the record company shall be reported as an asset if the past performance and current popularity of the artist provides a sound basis for estimating that the cost will be recovered from future sales. Otherwise, that cost shall be charged to expense. The amount recognized as an asset shall be amortized over the estimated life of the recorded performance using a method that reasonably relates the amount to the net revenue expected to be realized.

12. The portion of the cost of a record master recoverable from the artist's royalties shall be accounted for as an advance royalty, as discussed in paragraph 10.

Disclosure

13. Commitments for artist advances payable in future years and future royalty guarantees shall be disclosed.

14. The portion of the cost of record masters borne by the record company that are recorded as assets shall be disclosed separately.

Licensee Accounting

15. If minimum guarantees are paid in advance by a licensee, such minimum guarantees shall be reported as an asset by the licensee and subsequently charged to expense in accordance with the terms of the license agreement. If all or a portion of the minimum guarantee subsequently appears not to be recoverable through future use of the rights obtained under the license, the nonrecoverable portion shall be charged to expense. Other fees, if any, required by the licensing agreement (for example, for free records distributed by a record club in excess of a stipulated number) that are not fixed in amount prior to the expiration date of the agreement shall be estimated and accrued on a license-by-license basis by the licensee.

Amendment to Statement No. 32

16. The reference to AICPA Statement of Position 76-1, *Accounting Practices in the Record and Music Industry*, is deleted from Appendix A of Statement 32.

Effective Date and Transition

17. This Statement shall be effective for financial statements for fiscal years beginning after December 15, 1981. Earlier application is encouraged. The provisions of this Statement shall be applied retroactively and any accompanying financial statements presented for prior periods shall be restated.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix: GLOSSARY

18. This appendix defines certain terms that are used in this Statement.

Advance Royalty

An amount paid to music publishers, record producers, songwriters, or other artists in advance of their earning royalties from record or music sales. Such an amount is based on contractual terms and is generally nonrefundable.

License Agreements

Contractual arrangements entered into by an owner (licensor) of a record master or music copyright with a licensee granting the licensee the right to sell or distribute records or music for a fixed fee paid to the licensor or for a fee based on sales of records or music. License agreements are modifications of the compulsory provisions of the copyright law.

Minimum Guarantee

An amount paid in advance by a licensee to a licensor for the right to sell or distribute records or music.

Record Master

The master tape resulting from the performance of the artist. It is used to produce molds for commercial record production and other tapes for use in making cartridges, cassettes, and reel tapes. The costs of producing a record master include (a) the cost of the musical talent (musicians, vocal background, and arrangements); (b) the cost of the technical talent for engineering, directing, and mixing; (c) costs for the use of the equipment to record and produce the master; and (d) studio facility charges. Under the standard type of artist contract, the record company bears a portion of the costs and recovers a portion of the cost from the artist out of designated royalties earned. However, either party may bear all or most of the cost.

Royalties

Amounts paid to record producers, songwriters, or other artists for their participation in making records and to music publishers for their copyright interest in music. Amounts for artists are determined by the terms of personal service contracts negotiated between the artists and record companies and usually are determined based upon a percentage of sales activity and license fee income, adjusted for estimated sales returns. Royalties for publishing are based on the copyright or other applicable laws, but the requirements of the law may be modified by licenses issued by the publishers.

Footnotes

FAS50, Footnote 1--The term *specialized* is used to refer to those accounting and reporting principles and practices in AICPA Guides and SOPs that are neither superseded by nor contained in Accounting Research Bulletins, APB Opinions, FASB Statements, or FASB Interpretations.

FAS50, Footnote 2--Terms defined in the glossary (appendix) are in **boldface type** the first time they appear in this Statement.