



# Media & Entertainment Insights

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*Turning the science of business into an art.*

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## Buzz from the Street

By: [Barbara Israel](#), Partner - WeiserMazars LLP



Clients often ask us for our insight on the media marketplace. In particular, traditional publishers are interested in understanding the impact of new media. Another frequent query by all media clients is what we are seeing in the merger and acquisition landscape.

### New Media:

- The conversion of delivery of product from print to digital has resulted in expected savings in paper, print and postage. However, technology and salary costs have increased, partially eroding improvement in gross margins. This is because in order to attract and keep the digital reader, they must be more “engaged.” Thus, companies are facing increased labor costs to design and program reader interactivity and to refresh/update content.
- Publishers have had to educate advertisers that copying print ads to a digital delivery is not effective. As with content, the readers need to be engaged with interactivity.
- Subscribers have become increasingly more willing to pay similar prices for digital-only subscriptions as for print subscriptions.
- Publishers have generally been successful in charging incremental subscription revenue to subscribers who opt to receive both print and digital editions.
- Publishers see digital products as providing the potential to earn revenues which are more commensurate with the value of the content/information.
- The digital “store” has provided publishers with an additional source of revenue to partially offset erosion of advertising revenues due to the continued softness in the economy and the competitive impact of internet and broadcast advertising.
- The cost of circulation development via email is less costly than direct mail, though response and pay-up rates tend to be lower.
- Mobile telephone applications (iPhone and Android) are perceived as “must haves” as the importance of social media continues to escalate. What is challenging, however, is the inability at the present time to measure any type of return on investment, as currently the technology is not in place to identify whether the visitor to a website is new or a repeat.

### Mergers and Acquisitions:

- Expectations are for heightened activity over the next 18 months, with continued strong interest from both strategic and private equity buyers.
- Typical reasons for seeking an acquisition include seeking new services, products, clients and internal talent, with a particular focus on new technologies, digital marketing and digital content-apps, streaming on-line video and mobile phones.
- Expected multiples not significantly different than 2011.
- The expectation for continued low interest rates and the potential for changes in tax rates following the November elections could create the incentive for sellers to “test” the market in the first half of the year. Those that don’t receive an offer at the desired price will continue to take steps to improve EBITDA, by continuing to invest and monetize their digital activities, as well as controlling operating costs.

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## State and Local Issues Affecting Electronic Publishing



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Electronic publishers, as business entities, face unique challenges in determining compliance for state and local tax purposes. For either income and franchise taxes or for sales and use tax, the business model of an electronic publisher may create an unclear view with respect to when an obligation to pay and comply with these taxes exists.

First, the overall legal framework dealing with the jurisdictional power of a state to tax as a result of a nexus or connection between a state and the activities from which the business's income is derived still holds regardless of whether a business is a traditional one or a newer type of model such as electronic publishing. That framework is governed by certain provisions of the U.S. Constitution as interpreted by the U.S. Supreme Court and federal legislation. Regardless of the type of entity or business activity, a state must meet the burdens imposed by both the Due Process and Commerce Clause of the U.S. Constitution. Oversimplified, these provisions of the Constitution deal with whether the business has at a minimum acted sufficiently to take advantage of a state's jurisdiction and accordingly should have notice that it would be subject to tax and whether the state's imposition of the tax unduly burdens or otherwise inhibits the free flow of trade among the states. U.S. Supreme Court cases defining the tests for these provisions vary as regards their underlying facts, but hinge on whether the business is "doing business" in a state to such a degree that those activities would meet the nexus thresholds.

In practice most businesses selling tangible property or providing a service of some kind can envisage their activities in a state as soliciting the sale of goods or services, servicing customers, and maintaining customer relationships among a host of other common functions that may be done to secure or preserve the business model. In order to effectuate these functions, for example, a business may maintain an office, engage employees or independent contractors, advertise, own or rent real property, and negotiate contracts. These activities would generally give rise to nexus for most businesses but electronic publishers may conceivably find upon evaluation that none of these activities exist in any jurisdiction outside, perhaps, the one state in which they operate. At the same time, given the nature of a product that is electronic and, thereby, intangible the customers could conceivably and reasonably be in many jurisdictions. Revenue generated could, therefore, be concentrated or diversified, in jurisdictions where the electronic publisher has never done anything outside of delivering a publication via electronic means.

The concept of "economic nexus" as a theory for reaching businesses without the traditional notions of activity in a state has been developing rapidly. Consequently, it is this concept that a state may use to seek to pull in an electronic publisher into its taxing regime for purposes of income and franchise tax. Economic nexus involves an analysis of the economic benefit a business derives from a particular jurisdiction. Some states that have adopted the theory have imposed the standard by the use of specific thresholds or "bright line" standards and or coupled with a general narrative. For example one jurisdiction's statute states that "a purposeful direction of business toward this state, examined in light of the frequency, quantity and systematic nature of a company's economic contacts with this state, without regard to physical presence, and to the extent permitted by the Constitution of the United States" but then continues to relay in a separate publication that a business with receipts of less than \$500,000 from sources within state shall not be deemed to have economic nexus.

Once it is established that nexus exists under either the traditional notions of nexus or through the economic nexus theory, then the issue becomes how much of the sales of such businesses should be sourced or "captured" for purposes of the base to which a state will impose its income or franchise tax. There are a number of sourcing rules and they vary across the spectrum from delivery destination, to cost of performance, to market-based

rules. Destination sourcing rules are generally applicable to tangible property, but may in some jurisdictions involve intangible property such as electronic publications based upon where the state deems the delivery of the product to take place. For example, is it deemed delivered at the point it is available for "download" off a server of the publisher or is it deemed delivered once accessed at the end users' computer? Cost of performance rules involve sourcing the receipts to the location where most of the cost to produce the product or service is incurred, while market-based sourcing rules generally focus on the address of the customer.

For purposes of other types of taxes such as sales and use taxes, electronic publishing can be taxed or exempt depending on the state's definition of such products vis-à-vis its laws. For example, it is not uncommon for certain types of publications such as "newspapers or periodicals, regardless of medium to be exempt." Conversely, other states include newspapers and periodicals and specifically define publications that are shipped or delivered to a purchaser by electronic means as included in the definition of "tangible personal property", which is generally subject to sales and use tax.

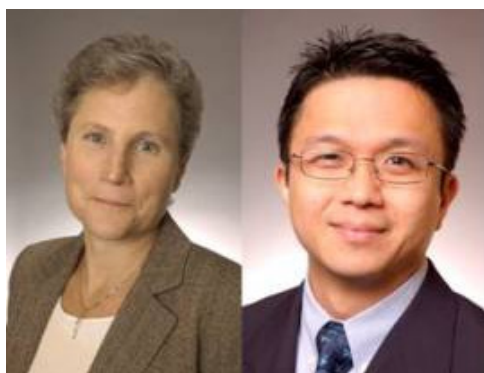
Given this varied and evolving landscape for state and local taxation, businesses engaging in electronic publishing may find it an opportune time to evaluate their state and local tax exposures, as the costs of noncompliance may be substantial.

Considerations should include the following:

- Taxing jurisdictions impose interest and penalties on unpaid taxes, there is generally no statute of limitations on the collection of taxes in the case of failure to file returns, and in many instances the rates for such interest and penalties exceed general market rates for use of money;
- Even in the case where it is determined that there are past liabilities, many states offer the opportunity to limit the look-back period for assessment of taxes and to limit penalties through amnesty or voluntary disclosure programs;
- In the case of sales taxes, failure to meet the obligation to collect taxes from the customer may effectively shift the tax burden to the vendor because the state will look to the vendor for payment of taxes that should have been collected.

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## Useful Insights on Debt, Revenue and Consolidation



By: [Barbara Israel](#), Partner - WeiserMazars LLP & [Roberto Bolanos](#), Senior Manager - WeiserMazars LLP

### Modification vs Extinguishment of Debt

If you have refinanced or amended your company's loan agreement, you should evaluate whether the loan agreement was modified or meets the criteria set by generally accepted accounting principles in ASC 470-50 for extinguishment.

If the present value of the cash flows under the amended loan agreement is substantially different (i.e. more than 10%) than the present value of the cash flows under the old agreement, extinguishment accounting should be followed. The following are certain guidelines that should be followed in determining whether the present value of the cash flows is substantially different:

- a. The cash flows of the new debt instrument should include all cash flows under the new debt instrument plus any amounts paid by the debtor to the creditor less any amounts received by the debtor from the creditor.
- b. Use the variable rate in effect at the date of the exchange or modification to calculate the cash flows of the variable-rate instrument, if the original debt instrument or the new debt instrument has a floating interest rate.
- c. The discount rate to be used to calculate the present value of the cash flows is the effective interest rate, for accounting purposes, of the original debt instrument.
- d. If the debt instruments contain contingent payment terms or unusual interest rate terms, use judgment to determine the appropriate cash flows.
- e. If, within a year, of the current transaction the debt has been exchanged or modified without being deemed to be substantially different, then the debt terms that existed a year ago shall be used to determine whether the current exchange or modification is substantially different.

Under extinguishment accounting, the fair value of the new loan is recorded as the new loan basis and a gain or loss on extinguishment is recorded. Gain or loss on extinguishment is calculated by deducting from the fair value of the new loan, the carrying value of the old loan including existing deferred fees on the old loan and any fees paid to the lender. Fees paid to third parties (e.g. legal fees) are capitalized and amortized over the remaining term using the effective interest rate method. If the present value of the cash flows is not substantially different, then modification accounting should be applied. Under modification accounting, no gain or loss is recorded. Existing deferred fees and fees paid to the lender are amortized over the remaining term using the effective interest method. Fees paid to third parties are expensed as incurred.

#### Revenue – Gross vs Net Considerations

The question of whether to present revenue on a gross basis or at net proceeds doesn't impact a business's net profits, but does impact its cost of sales and operating profit margins computed as a percentage of revenues. Businesses must evaluate the facts and exercise judgment as to whether revenue should be reported gross or net in instances where they sell product over the internet (never taking title to inventory and using third party drop shippers), outsource the fulfillment of customer services to a third party provider, and reimburse costs such as travel/out of pocket expenditures, or shipping/delivery charges. ASC 605-45 provides the following indicators that should be considered in reaching a conclusion as to presentation. It is important to note that a particular business transaction can have certain indicators which support a gross presentation and others a net; thus an evaluation based upon the overall facts and circumstances may be necessary.

<u>Gross Indicators</u>	<u>Net Indicators</u>
The entity is the primary obligor.*	The supplier is the primary obligor.*
The entity has credit risk.	The supplier has credit risk.
The entity has latitude in establishing price.*	The entity earns a fixed amount.
The entity has general inventory risk.*	
The entity changes the product or performs part of the service.	
The entity has discretion in supplier selection.	
The entity is involved in the determination of product or service specifications.	
The entity has physical loss inventory risk.	

\*Generally, these indicators carry more weight. However, relevant facts and circumstances should be considered to arrive at the appropriate conclusion.

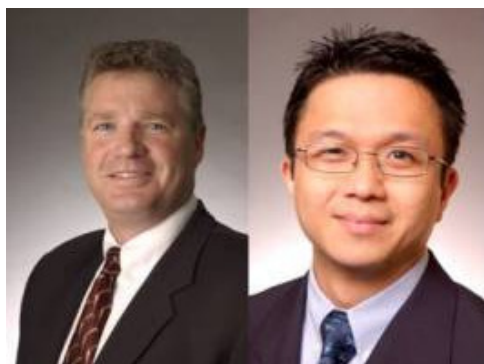
### To Consolidate or Not to Consolidate

When considering whether an entity could be subject to consolidation under ASC 810, the decision is typically based upon what is referred to in the accounting standards as the voting interest model. So when an entity has a controlling financial interest in an investee through direct or indirect ownership of a majority voting interest of the investee (ability to control), then the investee should be consolidated. Also, if the entity has effective control (e.g., majority board seats; conversion of convertible debentures) over the investee, such investee meets the criteria for inclusion in the entity's consolidated financial statements, even if it does not have a controlling financial interest through majority ownership. When there is neither a controlling financial interest, nor effective control over an investee, the cost or equity method of accounting should be used. When an entity owns more than 20% of the outstanding voting stock of an investee, there is a presumption that it also has the ability to exercise significant influence over its operating and financial policies; hence the equity method of accounting is used. Significant influence can be demonstrated through representation on the board of directors, by participation in policy-making processes of the investee or in other ways. The cost method of accounting is used if an entity does not have the ability to exercise significant influence over the investee.

There are circumstances when consolidation is required under the accounting standards, even absent an ownership interest in a business (Variable Interest Entity model or VIE), when the reporting entity is the primary beneficiary of the relationship. The primary beneficiary of a VIE is the enterprise that has (a) the power to direct the activities that most significantly impact the VIE's economic performance and (b) the obligation to absorb losses or the right to receive the benefits of the VIE. Unfortunately, the accounting standards don't provide a definition of a VIE but rather set forth conditions that are indicative of its existence. Such conditions include, but are not limited to (a) the management of an unconsolidated business by a related party, (b) a relationship whereby substantially all of an enterprise's revenues stem from products/services sold to one entity, (c) thin capitalization, whereby equity holders have not made sufficient investments to allow for the business to finance its activities and could be protected from absorbing losses, or (d) funds to start or expand a business are supplied by the reporting entity. Thus, if an entity is the primary beneficiary of a VIE and one of the aforementioned conditions is met, consolidation is probably required.

For guidance on any of these please contact Bert Bolanos at [Roberto.Bolanos@WeiserMazars.com](mailto:Roberto.Bolanos@WeiserMazars.com) (646-435-1599) or Barbara Israel at [Barbara.Israel@WeiserMazars.com](mailto:Barbara.Israel@WeiserMazars.com) (212-375-6566).

## Impairment Testing for Goodwill to be Simplified



By: [Joe Greeley](#), Senior Manager - WeiserMazars LLP & [Roberto Bolanos](#), Senior Manager - WeiserMazars LLP

The FASB, in response to concerns regarding the complexity and cost associated with impairment testing raised by preparers of private company financial statements, has issued amendment (ASU 2011-08) to Subtopic 350-20 that will simplify the rules for testing goodwill for impairment. Goodwill impairment occurs when the implied fair value of goodwill in a Company's reporting unit declines to an amount that is less than its carrying amount. ASU 2011-08 will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning

after December 15, 2011. However, early adoption is permitted. ASU 2011-08 will allow both private and public entities, the option, in certain circumstances to use a qualitative approach to test goodwill for impairment.

The qualitative assessment of potential goodwill impairment, which is to be made at the reporting unit level, would include factors such as:

- Macroeconomic conditions such as a general deterioration, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets.
- Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline (both absolute and relative to its peers) in market-dependent multiples or metrics, a change in the market for an entity's products or services, or regulatory or political developments.
- Increases in raw materials, labor, or other costs that have a negative effect on earnings. Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results.
- Entity-specific events such as negative operating income and cash flows or significant declines in operating income and cash flows, changes in management, key personnel, strategy, or customers, contemplation of bankruptcy, or litigation.
- Events affecting a reporting unit such as a change in the carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing all or a portion of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.
- If applicable, a sustained decrease in share price.

If an entity determines after assessing all qualitative factors (events and circumstances), that it is more likely than not (meaning a likelihood of more than 50 percent), that the fair value of a reporting unit is greater than its carrying amount, then performing the quantitative two-step impairment test required by the FASB prior to amendment will not be necessary. If the entity concludes otherwise, then it will be required to perform the first step of the two-step impairment required by the current guidance. The amendment does not permit an entity to carry forward its detailed calculation of a reporting unit's fair value from a prior year as previously allowed. Under the new guidance, an entity may choose to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step test. An entity may resume performing the qualitative assessment in any subsequent period. The amendments do not change how an entity measures goodwill impairment loss, nor does it revise the requirement to test goodwill annually for impairment and between annual tests whenever there is an indication of impairment.

This test consists of a two-step process and will continue to be used if the more likely than not qualitative factors are not satisfied:

#### **Step 1 Identify potential impairment:**

Determine whether the fair value of the reporting unit is less than its carrying amount, including goodwill. If the fair value of the reporting unit is less than the carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any.

The fair value of a reporting unit refers to the price that would be received to sell the unit as a whole in an orderly transaction between market participants at the measurement date. Under the first step, the reporting unit's fair value, including goodwill, is measured by using an appropriate valuation technique, such as a discounted cash-flow method. Other valuation techniques based on multiples of earnings or revenue or a similar performance measure may be used if that technique is consistent with the objective of measuring fair value.

#### **Step 2 Measure the amount of impairment loss:**

Determine the implied fair value of the goodwill of the reporting unit by assigning the fair value of the reporting unit used in step 1 to all the assets and liabilities of that reporting unit (including any unrecognized intangible

assets) as if the reporting unit had been acquired in a business combination. (It is important to note that this assignment process is performed only for the purposes of testing goodwill for impairment and does not result in either a write up or a write down of a recognized asset/liability or the recognition of a previously unrecognized intangible asset as a result of this allocation.)

Compare the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill to determine whether goodwill is impaired. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized equal to that excess. The loss recognized cannot exceed the carry amount of goodwill.

The FASB recognizes that the amendments in this Update do not advance the convergence of U.S. Generally Accepted Accounting Principles (Topic 350) with International Financial Reporting Standards IAS 36, Impairment of Assets, requires an entity to test goodwill for impairment using a single-step quantitative test performed at the level of a cash-generating unit or group of cash-generating units. The test must be performed at least annually and between annual tests whenever there is an indication of impairment.

### **Goodwill Impairment Testing for Reporting Units with Zero or Negative Carry Amounts**

In 2010, the FASB issued ASU 2010-28 to address goodwill impairment testing for entities with reporting units that had either zero or a negative carrying value. In practice, some entities with separate reporting units having zero or negative carrying value had concluded that Step 1 of the impairment test was passed in those circumstances, because the fair value of their reporting unit was greater than zero, thus not Performing Step 2 of the test, despite factors suggesting that goodwill may be impaired. ASU 2010-28 modified step 1 of the goodwill impairment test for reporting units with a zero or negative carrying value, stating that under such circumstances an entity should perform step 2 of the impairment analysis when it is more likely than not that goodwill is impaired. In performing this step, the entity should consider adverse qualitative factors which are consistent with the events and circumstances previously discussed. If the carrying value of a reporting unit is zero or negative and an entity concludes it is more likely than not that goodwill impairment exists, the entity would advance directly to step 2 to calculate the goodwill impairment loss, if any.

### **Impairment of other long-lived assets**

It is not unusual for long-lived assets other than goodwill to potentially be impaired when goodwill has been impaired. So as a reminder, a long-lived asset (asset group) shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The following are examples of such events or changes in circumstances under ASC 360-10-35-21:

1. A significant decrease in the market price of a long-lived asset
2. A significant adverse change in the extent or manner in which a long-lived asset is being used or in its physical condition
3. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset, including an adverse action or assessment by a regulator
4. An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset
5. A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset
6. A current expectation that, more likely than not (more than 50%), a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

The interplay of the factors above should be considered. The carrying amount of an asset group is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of

the asset group. An impairment loss is recognized only if the carrying amount of an asset group is not recoverable and exceeds its fair value. The impairment loss is measured as the amount by which the carrying amount of an asset group exceeds its fair value.

One challenge an entity may face is in the determination of its asset group. An asset group is the lowest level for which identifiable cash flows are independent of the cash flows of other groups of assets. All relevant facts and circumstances should be evaluated in determining an entity's asset group.

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