Morison KSi

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Your Global Advisers: Media and Entertainment

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Morison KSi

Editorial

By Graham Tyler, Kingston Smith, UK

Welcome to the second edition of the Morison KSi Media Group newsletter.

The Media Group continues to strengthen, not only as we now have more members, but have also been able to share staff between member firms. This increases knowledge sharing and improves the ease with which we work together.

The focus of my editorial in May 2018 was the rise of social media and it is no surprise that this continues to dominate the agenda. Regulation concerns continue to persist with Facebook, in particular, facing on-going scrutiny. However, from a practical perspective, consumers have started to wean themselves off banner advertising in our internet browsers. Nonetheless, this has just resulted in advertisers becoming more sophisticated with adverts on Alexa, in-story adverts on Instagram and the recent launch by Google of Adlingo, which combines a Chatbot with a standard Clickable Ad to facilitate interaction with the consumer.

The possible integration of Instagram, Messenger and WhatsApp would allow cross-platform communication and will likely only see a further opportunity for advertisers to enhance their offering.

With all this in mind, we have included a piece on whether social media assets should be valued, which will become an increasingly pertinent discussion.

The rise of the social media is coupled with an ongoing change in our TV viewing habits. Netflix has announced it believes that 10% of all viewing is now on their platform which perhaps explains the entry into the market of Disney, Time Warner and possibly Walmart (although their plans are less clear).

The increasing amount of choice for consumers creates an ever-evolving challenge for the advertising industry, one which their creative talents appear well placed to meet.

Equally, this landscape creates a challenging tax and accounting landscape where clients will demand a coherent, imaginative and high quality approach which only media specialist advisors will be able to provide.

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Morison KSi

Evolution or revolution? Kingston Smith's 2018 annual survey

By Esther Carder, Kingston Smith, UK

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Each year, Kingston Smith produce a survey on the financial performance of the marketing services industry. We launch the survey at a seminar that is attended by over 250 senior personnel from the media industry. This year, we were lucky enough to secure Sir Martin Sorrell as our keynote speaker.

In total, we review the results of over 250 companies across the following sectors:

- Advertising
- Digital
- Design and branding
- Marketing and sales promotion (MSP)
- Media planning and buying
- Public relations (PR).

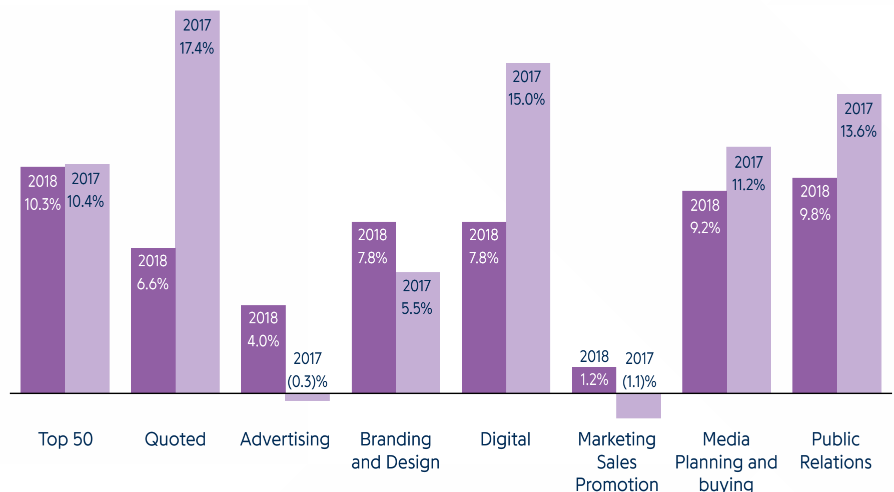
We analyse companies' financial performance, efficiency and productivity. Some of these companies are independent agencies; others are part of a listed group.

We thought it would be interesting to share an overview of our survey results with you. The marketing services industry delivered a mixed bag of results in this year's survey, as it continues to deal with the revolutionary rather than evolutionary change of pace within the industry. Brexit, reduced client budgets, digital disruption, disintermediation, increased in-housing and access to talent are just some of the challenges currently faced. However, despite this and the adaptation and restructuring that have been necessary to respond to some of these pressures, collectively the UK marketing services industry has shown year-on-year growth in fee income.

Agencies managed to achieve growth across the board in the last year, with total fee income increasing by 7.1% and all eight sectors achieving growth in fee income in the year. The top 50 independent agencies (a mixture of marketing disciplines) were the only subgroup to achieve double-digit growth, which was consistent with the three previous years at 10.3%. There was a reasonable amount of merger and acquisition activity that boosted growth here, but improved service offerings that capture the changing marketing services landscape also contributed to the results.

The MSP sector remains stubbornly flat, with just 1.2% growth and following the WPP-driven 17.4% growth seen in the quoted agencies last year, growth in fee income for the UK quoted sector is back down to a slightly more sustainable 6.6%. Special mention, however, goes

Gross income growth



to the advertising sector which, following a stagnant 2016, achieved a slightly more encouraging 4% growth in fee income in the year.

However, as we have seen in recent years, agencies are still struggling to turn this growth in fee income into increased profit. Average operating profit margins (being a before-tax profit margin) across the whole survey remain low at 12%, with only half the subsectors surveyed managing to translate growth in income into improved profit margins.

Operating profit margin is a key performance indicator for agencies. The Kingston Smith target for any marketing services business is an operating profit margin of 15%; however, for premium businesses or those with a specialism, this should be closer to 20%. Although none of the individual sectors achieved the minimum target, the design sector was the closest with an operating profit margin of 14.9%. Generally, agencies have struggled with rising staff and freelance costs – notably media planning and buying agencies, where the changing model for that sector has depressed operating profit margins to the lowest-ever average of 12.2%.

Last year, the industry prepared for what surely would be a continuing shortage of top-level creative talent, with the increased pressures surrounding employment and retention of key staff resulting in escalating staff costs. In line with expectations, employment costs increased across all sectors in the past year, reaching an average high of £62,415 per head.

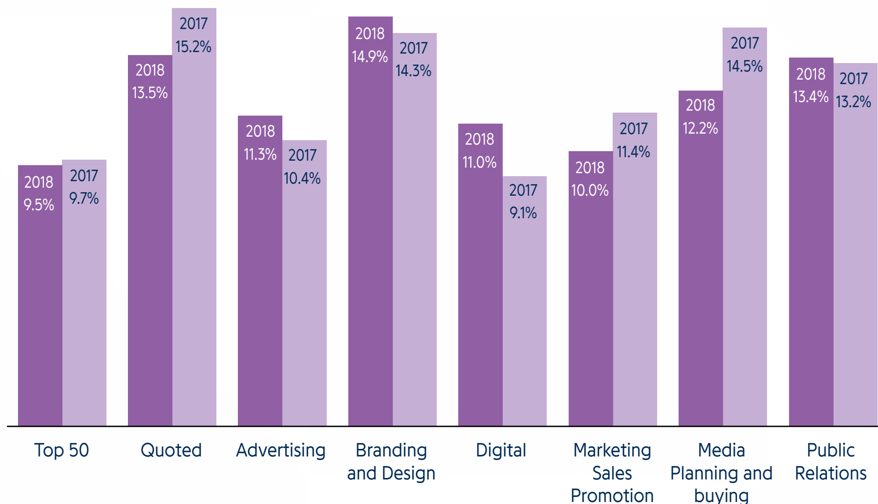
We have yet to see what impact a post-Brexit Britain will have, but it's likely to further reduce access to talent, making it even more expensive. All this alongside the prospect of having to put freelancers onto the payroll from April 2019, as the off-payroll working rules come in to effect, is likely to mean further financial strain. Whether it will lead to a cooling-off of what will surely be a smaller freelance market remains to be seen.

One of the key ratios for any agency to monitor is the proportion of fee income spent on staff costs. The Kingston Smith target ratio for spend on staff costs is 55%, with an increased target of 60% on total people costs once freelancers/ contractors are included. The amount of fee income spent on staff costs reduced again this year, by 1.9%, to 58.6%. However, spend on expensive freelance talent continues to be high and sector averages for total people costs tend to vary between 60% and 65% of fee income.

Non-labour overhead costs have had a large negative impact on operating profit margins. Agencies have seen restructuring costs, overseas investment and increased rental costs, particularly in the London-based agencies.

Overall, marketing services agencies have continued to achieve growth in fee income despite the challenging and unpredictable market conditions. However, with the industry struggling to convert fee income into profit, average operating profit margins remain low. Given all the pressures facing the industry and with Brexit just around the corner, we do not expect to see any particular improvements in the near future – and life is likely to get tougher before it gets better, with clients demanding 'faster, better, cheaper'. However, there is quite a range of performance across the survey, and as ever there are some agencies that manage to outshine the rest with their continued ability to be agile and adapt to clients' needs.

Operating profit margin



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Heads up for responsible advertisement

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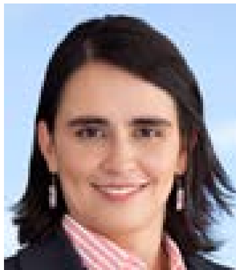

Times have undoubtedly changed. Equality is the goal of many fights around issues such as gender, race and sexual preference; roles divided by prejudice are no longer accepted.

Although few legal systems have specific rules governing such issues, social media has facilitated consumer feedback on ads that are launched into the market. Consumers are no longer distant from manufacturers and distributors; market research is no longer needed to determine how a particular ad was received. Social media has closed the gap, making it easy for consumers to criticise or support advertising campaigns.

Reaction (either positive or negative) towards an ad is immediate. Most robust trademarks know how their advertising has been received and can adapt easily to global trends and preferences – or can deliberately adopt a disruptive practice to create 'noise'.

Latin America has seen its share of controversial ad campaigns.

In Colombia, to promote tickets to Barranquilla (a city known as 'the Arenosa' – meaning 'sandy'), an airline ad used the strapline: 'Take your mistress to the Arenosa'. The word for 'mistress' (*la moza*) is demeaning to women. The ad was strongly rejected not only by consumers, but also by the Office for Human Rights of the Ministry of Interior, which requested a modification on the basis that the ad promoted discrimination and sexism against women. Despite – or perhaps because of – such an adverse reaction, the ad prompted a threefold increase in sales of air tickets to Barranquilla.

Sometimes we are so used to discrimination and gender presumption that we fail to notice the underlying messages hidden in even apparently positive advertisements. Also in Colombia, a makeup company disguises sexism with positive messages: 'Nothing makes you feel more beautiful than your achievements', declares their ad. However, what the commercial actually conveys is that makeup helps to reveal the best within women, that only women wearing makeup can feel secure and beautiful. This message has received its share of criticism. Nonetheless, it has gone unnoticed by many, as women have always been bombarded by commercials and social criticism regarding their appearance and what is expected from them, to the point that many have interiorised and accepted this, even from the products they buy.

In Argentina, a store chain launched a campaign to promote its toys for children. The ad panels aimed at boys were titled 'C for Champion' (a boy with a car, against a blue background) or 'C for Constructor' (a boy with a toolset). Those aimed

at girls were 'C for Cook' (a girl with a cooking set) and 'C for Coquette' (a girl with a beauty set, against a pink background). The implied clear division of roles came under fierce criticism, with social media featuring messages such as 'C for Caveman' to illustrate the outrageous sexism underlying the campaign. The company felt the need to apologise and removed the campaign, insisting that the ad did not reflect their position on diversity.

In Mexico, a chocolate bar manufacturer promoted its goods by suggesting that hunger makes a guy become a whiny girl. The National Council to Prevent Discrimination and the National Institute of Women both filed complaints, with both entities considering the ad to promote homophobia and misogynism through the denigration of women. Regardless of these strong claims based on the 1979 United Nations Convention on the Elimination of All Forms of Discrimination against Women, the company refused to accept its wrongdoing and continued the campaign on the basis that it was widely accepted in other countries.

Some attempts have been made to create equality – such as the creation of the Convention, which has been signed by 99 countries; the intervention of some courts tasked with prohibiting acts of discrimination, including any that appear in advertising; and the efforts of some self-regulatory entities that have developed general rules for advertisement, to avoid misrepresentation or improper insinuations that offend the morals or good customs prevailing in society or encourage any form of discrimination. Yet we still are far from achieving a *status quo* of non-discriminatory advertisement. More sensitive awareness is needed among advertisers if we are to reinforce positive messages, eliminate prejudice and embrace a more egalitarian world.

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The 12 feats of Hercules & Partners: Challenges and opportunities of the agency life cycle

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Hercules, the greatest of the Greek heroes, performed 12 difficult feats ('labours') in the course of his 12 years of service to King Eurystheus. But what would have happened if Hercules, as an entrepreneur, had started his own advertising agency? Would he have been able to deal with the challenges and opportunities of the agency life cycle? Let's see...

Some tips from the Oracle of Delphi before starting the journey

All advertising agencies face challenging tests as they go through each stage of their life cycle. To complete these successfully and ensure constant added value without compromising development, you must understand the difficulties you will face. To avoid taking the wrong path, you must always be prepared for the next stage. Training and planning are key to tackling the 12 feats: success will depend on your readiness to mitigate the threat of challenge factors by taking advantage of growth factors.

1st FEAT: Startup
Climbing Mount Erymanthos to capture the fearsome Erymanthian Boar

This is the time to define the basis on which the agency will develop.

It is essential to take time to define the culture that will be lived there every day and the agency's unique point of differentiation. Together, these make up the agency's 'DNA'. Three pillars must be established:

- **Partners:** It is important to evaluate potential companions for this long journey. What risks are they willing to take? Are they ready to change the way they think, from employee to entrepreneur? Are they trained for the different challenges that will arise? What goals do they pursue? Do their characteristics align with the agency's DNA?
- **Business:** Getting our first client. Consider: Who and why? What is our specific market? What do we have to offer? What should we never offer? How do we position ourselves? You must design the business plan and initial SWOT analysis.
- **Organisation:** Underestimating the 'business factors' of a creative business puts development and future growth at serious risk.

It's vital to get training and seek specialist advice in areas that we don't manage, to be equipped for making the best possible decisions.

2nd FEAT: Strengthening
Training with a Ceryneian Hind

It's time to take the second step and ... stop being just a crew with a tax ID!

We must now reassess the original plan and where we want to go, anticipating decisions beyond the current context. At this stage, we should look for the best professionals who share the agency's DNA and plan, and start working as a team. It is important to define how services will be remunerated and evaluate how clients and competitors view the agency.

3rd FEAT: Internal investment
Dressing sharp with the Belt of Hippolyta

At this point, positioning, clients, business plans and staff must be carefully aligned with the DNA that has been defined for the agency, to minimise deviations that could threaten the agency's integrity.

From now on, it will be essential to have reliable and timely information. Do we have this?

Developing and following a business plan, budgets and forecasts for each stage adds value.

We must also analyse: What is the necessary working capital? How will cash flow? What processes are needed to ensure quality?

In evaluating the potential projection of staff, we should consider: Can they go beyond their current function? Are training plans in place? It is essential to define roles and functions for the team.

4th FEAT: First growth phase
Battling the nine-headed Lernaean Hydra

Companies must continually develop plans for their corporate growth to improve or maintain their position in the market, but it is also essential to maintain harmonious growth of internal factors.

If the commercial growth is faster than the organisational growth and supporting areas are not prepared for that growth, the elements are unbalanced and can lead to failure. The same happens with the agency's financial planning: failure to anticipate the working capital needed to grow will result in an agency with huge potential, but that will not reach the end of next month.

5th FEAT: Reorganisation
Cleaning out the stables of King Augeas

If something needs to be changed, now is the time to do it! In future, there will be no chance to correct past mistakes.

We must consider the following questions: For the next stage, do we focus on profitability or growth? Are we leaving too many tax and legal contingencies open? Can we optimise tax planning? Do we keep our finances in order? Do we encourage long-term relationships with our clients? Are we capturing new ones? Are we basing decisions on long-term strategies, or just making short-term moves?

It is time to re-evaluate the agency's SWOT. Are we adding or losing value? What in the past was a distinctive feature may no longer be, for several reasons, including the evolution of competition.

Common agency weaknesses at this stage are: low income, poor financial information, dependence on a client, non-specialist services, lack of planning. Ask: Do we know if we're doing our job really well?

6th FEAT: Second growth phase
Beating the Nemean Lion in Cannes

Having strengthened ourselves in the previous stage, we are ready for further growth; but we must be more selective than in the first stage. We will have to analyse deeply how profitable our clients are, and understand how much value we bring to them. This is not just about profits; it's about building a sustainable business.

Human resources must become a strategic area. Our main assets and resources depend on that.

7th FEAT: Resilience
Cerberus has bad breath!

Lurking in the shadows, the three-headed hound Cerberus is always on guard, ready to send the brave entrepreneur through the gates of the Underworld. Sooner or later, he will catch us. Without the stage of Resilience, it would be impossible to get back on track. Our ability to pass through unscathed depends on realising that we will have to face this danger at least once. We must never believe that failure will never knock at our door.

It may be tempting to ignore the terrors of this unwelcome stage, but it's crucial to accept that it can happen at any point in the agency's life cycle. The risks affect startups and consolidated companies alike; but when danger strikes in the initial stages of the life cycle, it is usually fatal for the agency – which is why only a small percentage of companies survive the startup stage.

If our plans suddenly collapse, then to avoid becoming obsolete we must urgently use our resilience capacity combined with major organisational surgery to re-engineer and reposition the agency.

Decisions taken at previous stages will be fundamental in determining how prepared we are for this moment ... or, indeed, they may have caused the situation. We should focus on:

- Keeping the core structure
- Maintaining the areas that add value
- Strategy, creativity, planning and client relations
- Analysing clients and their profitability
- Horizontal integration
- Synergies of costs and revenues with other agencies
- Vertical integration
- Outsourcing to key suppliers in areas that are not 'core'.

This is not just about cutting costs; it is optimising use of resources.

8th FEAT: Redefinition
Feeding the cattle of the Monster Geryon

We've survived the storm; what next?

It is time to evaluate whether to continue growing alone or in collaboration. Are we ready for that change?

In this new stage, who should we really be competing against? Are we in a position to compete with them?

Do we have reasons to sell? (They can be financial, lack of succession, problems among shareholders, difficulties with competition, lack of volume or cash out.)

Are we interested in buying or associating? (This option could be chosen to expand the business model, strengthen competitiveness, consolidate the market, combine resources or acquire capabilities.) Are we in a suitable financial condition to do this?

A merger can be another option: it generates cost synergies while increasing critical mass, enabling cross-selling and combining resources. But is the potential new partner compatible with the agency's DNA?

9th FEAT: 3rd phase of growth
Capturing the Cretan Wall Street Bull

To keep rolling, we must develop sustainable and growing business.

In evaluate this stage of the agency's life cycle, we should consider: Where do we want to go? Are we going the right way? Are we ready for regional or international expansion? Do we have recognised and diversified clients? Are we finally recognised in the market? And how about our free cash flows? Do we pay salaries at or over the market? Does our agency show market KPIs? Do we have enough critical mass, or does our market share remain marginal?

10th FEAT: Succession planning
Avoiding the lethal bites of Stymphalian Birds

Sustainable agencies need continuity in management. Do we have a strong team? With management capabilities? Will we be able to keep them for a long time? A management that is over-dependent on the current owner, or relies heavily on one or two key people, undermines the agency's sustainability.

11th FEAT: Adapting to change
Riding the Mares of Diomedes. Who dares to take the reins?

New partners, new management, new bosses. How do we align objectives now?

How do we integrate? How do we realise the planned synergies? How do we communicate now? Will it affect our culture?

Do we have a post-merger plan? Who carries it forward? Merger operations usually fail because of the lack of a post-merger integration plan.

12th FEAT: Leadership
Do not be blinded by the Golden Apples of the Hesperides

Good news: We lead the market!

Bad news: We have just gained a lot of enemies...

We are at the centre of the action. It is an excellent time to attract the best talent and innovate permanently.

But there are also many challenges:
- Maintain positioning as a strategic partner of our clients, while keeping core structure as flexible as possible
- Do not neglect the factors that brought us here
- Evaluate the risks of each decision.

There is no need to be paranoid, but the competition is always ready to pounce if we set a foot wrong...

Looking back on the journey and remembering the Oracle of Delphi's advice

To have a successful agency, we must provide advertisers with creative talent and brand positioning, but never forget that we will need the right business environment to achieve that.

Keep calm and enjoy the ride! Luckily Ciclope is now a craft festival, not a one-eyed giant chasing us through a dark labyrinth!

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Film industry funding opportunities in Malta

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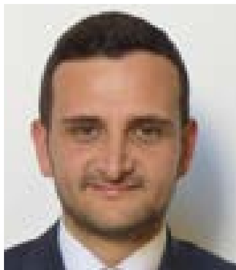

Bernard Charles Gauchi

Various locations in Malta and Gozo have appeared in international films, blockbuster movies and TV productions over the years. The country's natural landmarks, architectural treasures, and the availability of both actors and support crew as well as facilities available such as large water tanks with a natural sea-line backdrop make Malta an ideal location for any film plot. Additionally, using Malta as a production site can offer unrivalled financial and fiscal incentives.

Cash rebate – Financial aid

Malta is offering a cash rebate of up to 25% of qualifying expenditure (such as manpower costs, accommodation, transport, hiring, fees, ancillary administrative costs, etc) incurred while filming in Malta upon completion thereof. This incentive is quite flexible and applies irrespective of whether the production involves a full cinema movie, TV production, mini-series, animation or documentaries as long as it is at least partially produced in Malta. This could be increased by a further 2% (hence up to 27% in total) if the film features Malta's culture.

Tax credit – Fiscal aid

Eligible expenditure incurred with respect to the facilities used for filming and audiovisual productions could give rise to a tax credit of up to 50%. Another incentive is that companies contributing towards the production of local films and training initiatives offered by the Malta Film Commission could benefit from a 150% tax deduction, up to a maximum of €50,000.

VAT

The general VAT rate in Malta stands at 18%, while accommodation in hotels and premises is offered at a reduced rate of 7%. In general, VAT incurred on expenditure attributable to business activities is fully refundable in Malta.

Investment aid

The Maltese government offers investment incentives with respect to necessities such as film studios and sets, filming and editing facilities, and equipment.

Some films featuring or shot in Malta

Gladiator • The Count of Monte Cristo • Game of Thrones • World War Z • Troy • Munich • Popeye • Search for Atlantis • Assassin's Creed • By the Sea • Asterix et Obélix • Au Service de Sa Majesté • The Devil's Double • Agora • The League of Extraordinary Gentlemen

KSi Malta can assist in the application for reimbursement and auditing of expenditure for films shot in Malta, and provide full assistance on all other elements that contribute to a successful production.

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Canada's film and television industry: An introduction

By Allen Sloan, Sloan Partners, Canada

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The Canadian film and television industry has come a long way since its humble beginnings at the turn of the last century, when the first films were shot in Niagara Falls and the Ontario Motion Picture Bureau was established. In 2017, Canadian film and television production volume was $8.38 billion and the industry generated 171,700 full-time equivalent jobs.

Sectors

The industry is divided into four major sectors:

- Foreign location and service production (~45%)
- Canadian film and television production (~39%)
- Broadcaster in-house productions
- Convergent digital media.

Some of the established production houses include:

- Big Coat Productions Inc.
- Boat Rocker Media
- Breakthrough Entertainment
- E1 Entertainment
- Guru Animation Studio Ltd
- Insight Production Company Ltd
- Marble Media
- Portfolio Entertainment Inc.
- Rhombus Media Inc.
- Shaftsbury Films Inc.
- Sinking Ship Entertainment Inc.
- Spin Master Ltd
- White Pine Studios.

These production houses and studios produce a variety of content including animation, feature films and documentaries, which are sold and distributed internationally.

Festivals and Events (Networking)

There are several festivals and events that are crucial to attend to stay abreast of the latest developments in the industry. Everyone associated with the industry – including accountants, lawyers, producers and broadcasters – makes an effort to have a presence at these events, since attendance is key to networking in the industry.

- Kidscreen (various dates and locations)
- Vancouver International Women in Film Festival (March)
- Hot Docs (April)
- MIPCOM/MIPTV Cannes (May and November)
- Banff World Media Festival (June)
- Toronto International Film Festival (September)

Associations and unions unique to the Industry

All industries have specialised bodies providing rules and structure. Some of the more significant organisations are:

- ACTRA – Alliance of Canadian Cinema, Television and Radio Artists
- CMPA – Canadian Media Producers Association
- DGC – Directors Guild of Canada
- IATSE – International Alliance of Theatrical Stage Employees, Moving Picture Technicians, Artists and Allied Crafts of the WGC – Writers Guild of Canada
- United States, its Territories and Canada.

Funding and financing

Crucial to the production of any television show or feature film is, of course, the financing. Financing plans and budgets is a tricky exercise as producers try to come up with the money to turn their dreams into reality.

Producers use a combination of licence fees from broadcasters and networks, funding from government and private sources, and tax credits at the federal and provincial levels.

Three of the popular broadcasters and networks where the producers sell their shows are Bell Media, Corus Entertainment and Rogers Media Group.

Some sources of government and private funding include:

- Bell Fund
- CMF – Canada Media Fund (two funding streams: Experimental and Convergent)
- Film Fund
- OMDC Export Fund (film and TV)
- Rogers Fund

Tax credits are including in some financing plans:

- Federal incentives
  - Cavco – Federal tax credit
  - OMDC – Provincial tax credit
- Provincial funds
  - Ontario Film & Television Tax Credit (OFTTC)
  - Ontario Production Services Tax Credit (OPSTC)
  - Ontario Computer Animation & Special Effects (OCASE).

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Get ready for the new lease accounting rules

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The largest expense for a media company is salary. The second major expense would be rent – and all the leases that come with it. The accounting world – under both Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) – is changing the way that leases are going to be accounted for, beginning in 2019. The new rules will affect all companies that lease office space, equipment and other assets. The new guidance is intended to increase transparency and streamline financial reporting across these organisations. We will focus on US GAAP rules in this article, but will also touch on some differences under IFRS rules.

A new way to account for leases

Most of the changes in the new standard were made to the way *lessees* account for lease-related assets and liabilities on their balance sheets. Generally speaking, all leases with a term of more than 12 months will need to be recognised on a lessee's balance sheet. This differs from current GAAP guidance, which requires only capital leases to be reported.

Lease term

The new standard defines the lease term as 'the non-cancellable period of the lease adjusted for options to renew the lease, terminate the lease or purchase the leased asset'. The renewal period must be included in the term if the lease can be renewed at the option of the lessee and the lessee is reasonably certain to exercise that option. If the lease can be renewed at the option of the lessor, the renewal period is included in the term, regardless of lessee intent.

Lease components

Once a lease is identified as subject to the new standard, an entity needs to consider whether the contract includes more than one lease component or non-lease components. When the lease includes non-lease components, such as cleaning services, gym access, concierge services or building security, the fixed payments to be paid during the lease term need to be allocated based on the relative standalone prices of those components. A lessee is permitted, however, to elect to account for each lease component and its related non-lease components as a single lease asset.

Lease recognition and measurement

Some of the most significant updates to the US standard affect the way lessees and lessors recognise and measure leases on their balance sheets. Lessees must now record a lease liability and a related right-of-use (ROU) asset on their balance sheets on the *commencement date of the lease*. The lease liability figure is determined by the present value of future lease payments. A ROU asset is based on the cost of the asset, including the lease liability, pre-payments and initial direct costs (i.e. incremental costs that an entity would not have incurred had the lease not been obtained). The ROU asset will be amortised over the life of the lease period, and the corresponding adjustment will be to the rent expense account. The amortisation will be based on the total future lease payments, not just the present value. The lease liability figure will be adjusted over the life of the lease to reflect the present value at each reporting date, and the corresponding debit or credit will be an adjustment to the ROU.

Therefore, under GAAP, the impact to the income statement will be nominal. However, under the IFRS method, ROU will be amortised or depreciated as an expense based on

the initial present value of the lease liability (plus costs of the lease and initial payments). The lease liability will be amortised as debt with the lease payments allocated between principal and interest expense. Consequently, under IFRS, there will be a greater amount of expense in the early portion of the lease and less towards the end. Also, under IFRS, a significant portion of the expense will be explicitly interest expense on the statement of profit and loss.

The IFRS statement of cash flows will show the portion of lease payment allocated to principal as a financing cash flow. The interest portion would be treated in accordance with the entity's policy for interest payments in the statement of cash flows. Under GAAP, all lease payments are operating cash flows.

Short-term leases

Under the new standard, a lessee can elect to exclude short-term leases from the ROU asset and lease liability. Short-term leases have a term of 12 months or less and do not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise.

Disclosures

Lessees and lessors will be required to provide additional disclosures to help financial statement users assess the amount, timing and uncertainty of cash flows from leases. The disclosures include both qualitative and quantitative items. This will also need to be discussed with bankers as loan covenants may need to be modified due to changes in the liabilities of a company.

Preparing for the new lease accounting standard

While some leases are straightforward with relatively standard terms and conditions, many are complex agreements tailored to the specific needs of the lessee or requirements of the lessor. The more complex the transaction, the more complex the accounting.

Developing a transition plan should be an immediate priority for both public and private companies. Financial reporting personnel need to be educated regarding the application of the new standard, but individuals from departments other than accounting and reporting should also be involved in planning activities, such as:

- Identifying all leases
- Evaluating leases individually to determine applicable accounting model for each
- Subsequently accounting for each lease, including disclosures
- Assessing the impact on contractual agreements, such as bank loan covenants
- Evaluating the efficiency and effectiveness of existing processes and controls over leasing activities
- Ensuring that vendor products used to handle lease administration (i.e. classification, measurement and recognition) will be compliant under ASC 842 or IFRS 16, as applicable.

After initial implementation, the new standards will require ongoing evaluation of a company's leases to ensure compliance when any changes are made to a lease's terms, components, disclosures, and so on. With the help of your independent accountant, early planning and action are critical to ensure timely preparation and continual compliance.

If you have any questions or would like to discuss this article further, please contact:

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Shouldn't social media assets be valued?

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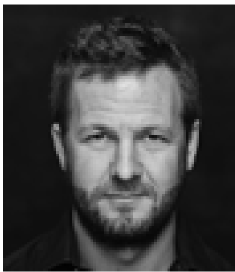

Shouldn't social media assets be valued?

Intangible assets increasingly represent the majority of balance sheet value in most companies. A 2015 study by Ocean Tomo LLC established that the component percentage of S&P 500 market value between intangible assets and tangible assets was 87% and 13% respectively, whereas in 1975 it was almost the opposite, at 17% and 83%.

Neither the definition of intangible assets for accounting purposes, nor typically-quoted examples of common intangible assets, have changed much in recent years. Digitalisation and the growing importance of social media, however, may have introduced new types of intangible assets that should be considered when accounting for value.

What are intangible assets?

IAS 38 defines intangible assets as non-monetary assets which are without physical substance and identifiable (either being separable or arising from contractual or other legal rights). It is a resource controlled by an entity as a result of past events and from which future economic benefits are expected.

Following business combinations, aside from any patents, developments or other such intellectual property, it is usual for valuers to recognise and attribute value to just two intangible asset classes: brands and customer relationships (contractual and non-contractual).

When required to value intangible assets, such as in the context of a business combination, it is common for valuers to excuse themselves from attributing value to an identified intangible asset class due to the fact that the future economic benefits and costs cannot be measured reliably. However, in business combinations, it is assumed that the fair value (and, therefore, cost) of an intangible asset acquired in a business combination can be measured reliably.

Perhaps it is time for both the accounting lawmakers and those attributing value to intangible assets to recognise the growing importance of digital.

Social media to the forefront of value?

Many businesses not only rely on, but base their entire business models around social media presence. The degree to which they are successful in obtaining a wide and effective social media audience will determine the business' own success. Shouldn't this be recognised when attributing value?

Perhaps more than any other industry sector, the above is relevant to the media industry: marketing and advertising firms who design strategies for their clients to sell more in the digital age. Two examples can be used to illustrate the point.

Online positioning as a business asset

Online strategy and optimisation of digital metrics that maximise a business' digital presence, and lead to greater sales conversion, are key to many businesses. Shouldn't it be valued?

Some may argue that digital presence is wrapped up within the value of brand. But digital positioning in social and other digital media is not necessarily brand, and may be separable from brand.

Similarly, can digital assets be bundled into workforce know-how? If the employees leave, the digital footprint remains.

Once an online business has muscled its way into the centre of the digital dance floor, lucrative positive cash flows can be expected, for at least a limited timeframe.

Although this is most evident for mobile app start-ups, even established businesses go through a digital transformation and establish a digital footprint, and thus create digital assets in the process.

Valuers shouldn't hide behind the separability criteria. It may be the case that digital assets can be transferred independently from brand, employees and know-how, and as such should not end up in the deep pool of goodwill.

The increasing influence of influencers

Influencers have been always been used in advertising and marketing campaigns. Allegedly, Josiah Wedgwood, an English potter and entrepreneur, paid the Royal Family to endorse his pottery in the 1700s. But social media has taken influencer marketing to a whole new level.

Increasingly, businesses are encouraged to consider the long-term relationship with their influencers. A reliable and faithful influencer can become a key business asset, so shouldn't it be recognised as an intangible asset?

In searching for valuation methods, valuers should look at how marketing agencies assess the return on investment of influencer campaigns. **Samy Road** is a Spanish company which uses proprietary technology to identify the most appropriate social media influencers for a particular brand. In identifying and managing influencer-led marketing campaigns, it uses two methods to value the impact of an influencer:

- Calculate the CPM ("cost per thousand") obtained from an influencer campaign and compare it with the CPM of the specific brand or sector. For example: an influencer paid €2,000 for a campaign that generates 80,000 impressions results in a CPM of €25. If the average CPM of the brand in Instagram is 30, it means that the value generated by the influencer is €5 per 1,000 impressions, or €400 for the campaign.
- Calculate value based on media interactions by comparing the cost of using an influencer against the cost of paid media. For example: for a social media post, if a "Like" costs €2 and a "Comment" costs €5, then the cost of an influencer campaign generating 2,000 Likes and 100 Comments would be €5,000. If the influencer is paid €2,000 for the same result, then €3,000 would be saved.

The above could be extrapolated to assess the lifetime value of an influencer for a particular brand. Influencers could be assessed and valued based on selected criteria, such as the number of followers, the number of brand-related posts per year and the number of social media interactions generated with each post. The expected lifetime of the influencer for a brand should also be assessed, considering the nature of the brand and of the influencer.

In assessing intangible asset value based on an estimate of future cash flows from an influencer, the risks associated with the influencer should be considered – both individual influencers and social media in general have a tendency to be rather fickle.

How far can social media go in creating value?

If Ocean Tomo does a study in twenty years' time, how much value will be attributable to intangible assets? And of this, how much could be attributable to social media?

As more and more business is generated and carried out digitally, maybe it is time to recognise the value of digital assets and to not shirk responsibility when valuing a business' intangible assets.

A final thought. How should accountants value Artificial Intelligence, when the computer codes and algorithms have the ability to think and create value independently?

If you have any questions or would like to discuss this article further, please contact:

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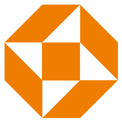

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