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Technology Spotlight

Recognizing Revenue From Sales in a Virtual World

In This Issue:

The Bottom Line

The "freemium" gaming model is a rapidly expanding niche in the online and mobile gaming industry, providing gamers with free access to online games and the ability to purchase premium features such as virtual currency and virtual goods.

- The "freemium" gaming model is a rapidly expanding niche in the online and mobile gaming industry, providing gamers with *free* access to online games and the ability to purchase *premium* features such as virtual currency and virtual goods to progress more quickly in the games or enhance their gaming experience.
- Entities often apply the guidance in SAB Topic 13.A[1] (codified in ASC 605-10-S99-1[2]) in developing accounting policies on this topic, since the freemium game software is generally hosted and often outside the scope of the software accounting guidance in ASC 985-605 (although certain arrangements may still be within the scope of ASC 985-605, depending on the facts and circumstances).
- The SEC staff views the sale of virtual goods in a freemium environment as a service and not the sale of an actual good. Gaming entities typically recognize revenue from the sale of virtual goods over their best estimate of the life of the (1) virtual good, (2) gamer (i.e., the period during which the gamer is expected to play the game), or (3) game.
- An entity may have to invest in resources and technology to track the information it needs to support its revenue recognition accounting policy for virtual goods and currency.
- Because of the frequent involvement of third-party sellers of virtual goods and currency, an entity must carefully consider all relevant facts and circumstances when determining whether to recognize revenue on a net basis (as an agent) or a gross basis (as a principal).

[1] SEC Staff Accounting Bulletin Topic 13.A, "Selected Revenue Recognition Issues."

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

Beyond the Bottom Line

This *Technology Spotlight* highlights various considerations associated with revenue recognition in the online and mobile gaming industry (hereinafter referred to as the "online gaming industry"), particularly the "freemium" gaming model.

Accounting standards do not specifically address the recognition of revenue from microtransactions under the freemium model, largely because such transactions are a recent, rapidly evolving development in the industry.

Background

Online gaming is one of the most rapidly developing technologies in the market today, leading to the creation of various mediums through which more and more people can access online games and seamlessly interact with other gaming enthusiasts in real time. Online game developers and operators (collectively, "gaming entities"[3]) are shifting away from a subscription- or fee-based business model to a freemium model, which is quickly becoming a lucrative and popular means of harnessing a substantial market share within the online gaming community.

Under the freemium model, gamers are given access to a gaming entity's online game free of charge (or for a nominal fee) and revenue is largely generated through "microtransactions" involving the sale of virtual goods and services ("virtual goods"). Virtual goods are nonphysical objects that enhance the gamer's playing experience or ability to make progress in the game and may take various forms (e.g., items such as clothing, equipment, weapons, speed, power, or health). Some of these virtual goods are consumed by the gamer over a specified period or number of usages, while others offer a more lasting benefit. Virtual goods may be purchased by using real currency or the gaming entity's virtual currency. This virtual currency can be purchased directly from the gaming entity, earned by playing the game, or purchased or received from third parties (e.g., as marketing incentives or as gifts from social network friends).

> Accounting standards do not specifically address the recognition of revenue from microtransactions under the freemium model, largely because such transactions are a recent, rapidly evolving development in the industry. In determining their accounting policies for the sale of virtual goods, gaming entities take into account the nature of the virtual good and overall game, industry practices, regulator views, and other general accounting guidance.

Key Accounting Issues

The sections below discuss certain transactions under the freemium and other similar gaming models, the accounting guidance applicable to those transactions, and the various approaches industry participants are applying when recognizing revenue. They also address emerging challenges that entities in the industry are confronting when determining an accounting policy to apply to these transactions. Entities are encouraged to review all sources of guidance identified in this document and, when necessary, involve their accounting advisers in the application of the appropriate guidance.

Existing Guidance

In the past, many gaming entities applied the guidance in ASC 985-605 when recognizing revenue from the development and sale of computer games, which historically involved the sale of game software on some form of removable media such as a compact disc. However, with the advent of online gaming and, specifically, the freemium gaming model, ASC 985-605 may not be applicable in certain instances because gamers are generally given access to a hosted software environment but not a contractual right to take

[3] Developers create and produce online freemium games as well as the virtual goods sold in these games. Developers generally distribute via their own Web site as well as on multiple third-party online and mobile technology platforms, which typically charge the developers a payment processing fee for each microtransaction processed.

possession of the software during the hosting period. As a result, gaming entities look to the guidance in ASC 605 and SAB Topic 13.A (codified in ASC 605-10-S99-1) when developing accounting policies on this topic. SAB Topic 13.A states that revenue should not be recognized until:

- Persuasive evidence of an arrangement exists.
- Delivery has occurred or services have been rendered.
- The seller's price to the buyer is fixed or determinable.
- Collectibility is reasonably assured.

For many microtransactions, three of the four criteria in SAB Topic 13.A are usually met at the time of sale. That is, the terms and conditions gamers must accept generally serve as evidence of the existence of an arrangement, the price of the virtual goods is typically fixed when purchases are made, and collectibility is usually reasonably assured since up-front payments are often required at the time of purchase. However, it can often be difficult to determine when "delivery has occurred or services have been rendered" for virtual goods, particularly because the structure, life, and use of virtual goods can vary significantly from game to game.

Regarding the assessment of delivery, the SEC staff views the sale of a virtual good as representing a service rather than the sale of an actual good. Because many virtual goods have an enduring benefit, entities have adopted accounting policies for recognizing revenue as these benefits are consumed over time (as a service) rather than at a single point in time (as a sale of a good). Given the lack of specific guidance on these transactions and the unique nature of each virtual good sold, similar entities risk developing diverse accounting policies for recognizing revenue under such circumstances, which may also be inconsistent with the SEC's views.

Given the lack of specific guidance on these transactions and the unique nature of each virtual good sold, similar entities risk developing diverse accounting policies for recognizing revenue under such circumstances, which may also be inconsistent with the SEC's views.

Although this publication focuses on the challenges associated with developing accounting policies for arrangements that are outside the scope of the software revenue recognition guidance in ASC 985-605, certain arrangements may still be within the scope of ASC 985-605 and thus could be subject to different accounting treatment.

Recently, gaming entities have focused on the mobile market by developing game applications for use on mobile devices, such as smartphones. To play many of these games, gamers must download a base version of the application for free or a nominal fee. Thereafter, they can connect to a store within the game and purchase virtual goods such as premium versions of the game or items that enhance their gaming experience (e.g., additional powers or weaponry). Some of these game applications enable gamers to play the games offline on their mobile devices. In such circumstances, an entity may need to consider whether the software application provided to a gamer is within the scope of the software revenue recognition guidance in ASC 985-605, since the gamer may have a contractual right to take possession of the software. An entity would need to evaluate all facts and circumstances associated with the arrangement when deciding which GAAP to apply to it.

Developing an Accounting Policy

In developing an appropriate accounting policy for the sale of virtual goods, gaming entities generally apply one of three methods (discussed below) for recognizing revenue, depending on the facts and circumstances associated with the arrangement with the gamer and the nature of the virtual goods being sold. The decision of which method to use should be based on how the virtual good is consumed by the gamer and how the deliverables are defined; however, entities may also need to consider the availability of information about how virtual goods are consumed to assess their ability to apply each of these methods. Although it may be helpful to use mass data storage devices and query tools, additional investment in resources to track and maintain the necessary information could be required. This challenge can affect the determination of an appropriate accounting policy and is considered below in the discussion of each of the methods.

Methods for Recognizing Revenue for the Sale of Virtual Goods

The three methods below for recognizing revenue associated with the sale of virtual goods are commonly used by entities operating in the freemium gaming industry.

Life of the Virtual Good

Under this method, revenue from the sale of virtual goods is recognized over the period during which the gamer is expected to be able to access and consume the benefits inherent in a purchased virtual good (i.e., the deliverable is deemed to be the virtual good, in which case revenue recognition mirrors the consumption of the virtual good by the gamer). This method is used when the virtual good is deemed a separate deliverable in the arrangement, since it provides the gamer with a specific benefit that can be consumed at a certain time or over a specified period or number of usages (other than the life of the gamer or of the game itself). Under this method, revenue is recognized over the estimated life of the virtual good (generally on a straight-line basis unless another systematic and rational basis better reflects the consumption of the virtual good), provided that the entity can reasonably estimate the virtual good's life. In certain circumstances, the virtual good may be consumed immediately upon (or shortly after) its delivery to the gamer (i.e., it may be used immediately by a gamer and provide no further enhancements), potentially resulting in recognition of the related revenue upon or shortly after delivery. However, an entity would need to consider the specific facts and circumstances carefully before making such a determination.

The deliverable is deemed to be the virtual good, in which case revenue recognition mirrors the consumption of the virtual good by the gamer.

One of the challenges in applying this method is gathering and maintaining the data necessary to determine or reasonably estimate[4] the life of the virtual good (i.e., the period over which the virtual good is consumed by each individual gamer). Given the sheer volume and continually evolving characteristics of virtual goods, it may be difficult to track the differing behaviors of a broad spectrum of gamers (not to mention that there is a potential for certain virtual goods to be traded in secondary markets). To track information at this level of detail, an entity may need sophisticated systems and significant time to store, process, and analyze the related data. Consequently, some gaming entities have concluded that even though they may be able to apply an accounting policy to recognize revenue over the life of the virtual good, this method is not appropriate because they do not have enough information to determine or reasonably estimate the virtual good's life. Therefore, some gaming entities may consider recognizing revenue over the period during which the gamer is expected to play the game or over the life of the game because this would at least result in the deferral of revenue over a period greater than the life of the virtual good.

The existence of sufficient reliable historical information may influence an entity's determination of the appropriate accounting policy because the entity may be required to recognize revenue over a gamer's or game's life when the life of the virtual good cannot be determined or reasonably estimated. However, an entity's lack of systems and processes to track readily available information should not, in and of itself, dictate its accounting policy. If an entity determines that the most appropriate method for recognizing revenue is over the life of a virtual good, the entity would need to make a reasonable effort to establish systems and processes for tracking the necessary information to support such a policy. The entity should only use another method when the available information does not enable it to determine or reasonably estimate the life of the virtual good.

[4] Entities may also have to consider whether, as evidence of a reasonable estimate of usage life, there is a sufficient history of the consumption pattern of newly introduced virtual goods.

Example

Entity A introduces a hosted freemium action tennis game into the market. To improve the playing experience of gamers, A develops two "super-nutrients" that can be purchased to enhance the performance of a gamer's avatar. The first nutrient, "Lobpro," gives a gamer's avatar additional strength and speed for one match in which the gamer participates. The second nutrient, "Ace," endows the avatar with increased strength and speed for the duration of a tournament, which potentially consists of several matches. The prices of the two nutrients differ considerably given the disparity in the benefits provided. Both super-nutrients are available for one-time use. On the basis of historical evidence, gamers typically complete a match in less than a day, while tournaments may take several days to complete.

Under these circumstances, A could recognize revenue associated with Lobpro over the period it takes the gamer to complete the match. Because the evidence has indicated that a match typically lasts less than a day, A would recognize revenue over that period and commence revenue recognition when the match involving the use of Lobpro begins.

Similarly, revenue associated with the purchase of Ace could be recognized over the period of the gamer's participation in a tournament. Because the periods in which gamers participate in a tournament may differ, it may be difficult to determine an appropriate period in which to recognize the related revenue. Entity A would need to have sufficient historical information regarding the typical tournament period (potentially by type of gamer) to estimate the manner in which the virtual good is consumed and hence the manner in which revenue would be recognized. Further, such estimates would need to be evaluated periodically to ensure that the pattern of consumption is still appropriate.

Some gaming entities may be able to determine an estimated life for all gamers provided that the pool of gamers is relatively homogeneous.

Life of the Gamer

Under this method, revenue is recognized on a systematic and rational basis over the period during which the gamer is expected to continue to play the game. This method is typically used when the gaming entity considers the gamer's overall gaming experience to be the ultimate deliverable in the arrangement and delivery of the benefits inherent in any virtual currency or good therefore takes place over the period in which the gamer continues to play the game. This method would also be appropriate when a virtual good is deemed to be the deliverable and provides a gamer with an enduring benefit that is consumed over the gamer's life or the life of the virtual good cannot be reasonably estimated.

As with revenue recognition over the life of the virtual good, it may be challenging for entities to gather and maintain the data they need to reasonably estimate the life of each gamer. Some gaming entities may be able to determine an estimated life for all gamers provided that the pool of gamers is relatively homogeneous (i.e., each gamer behaves similarly to others). Other entities may need to stratify the population of gamers on the basis of similar characteristics (such as gamers that purchase virtual goods versus those that do not) or group gamers by their activity level within the game so that they can estimate a life for each different pool of gamer. The appropriate level of disaggregation and the basis of recognizing revenue (straight-line or some other more representative systematic and rational basis) will depend on the degree of similarity between gamers' behaviors.

As previously mentioned, entities may need to track detailed gamer-level information when using this method. Consequently, some gaming entities have concluded that even though they may be able to recognize revenue over the life of the gamer, this method would not be appropriate because they do not have enough information to determine or reasonably estimate this life. Therefore, entities may consider recognizing revenue over the life of the game since this would at least result in the deferral of revenue over a period greater than the life of the gamer.

Life of the Game

Under this method, revenue is recognized over the estimated life of the game itself, which is generally the longest period over which recognition could take place. This method would be appropriate when an entity is unable to determine or reasonably estimate the gamer's life and the gamer's overall gaming experience is considered to be the ultimate deliverable in the arrangement. Similarly, it may also be appropriate to use this method when the virtual good is deemed to be the deliverable but the life of the virtual good or gamer cannot be reasonably estimated. This method may be particularly relevant when gamers are permitted to trade and transfer virtual goods or currency between one another, which could make the virtual good's and gamer's life indeterminable. The life of a game may be linked to a variety of factors, such as the degree to which a game's underlying source code has changed or the number of gamers who still participate in the game. An entity using such data points in estimating a game's life should track changes in such data and update its game-life estimate as of each reporting period.

Example

Gamer B plays a game developed by Company D. As part of the game, B is able to purchase an array of virtual goods such as clothing and weapons. Gamer B can also sell or trade such goods on a secondary market facilitated by a third party. Company D initially determines that it will recognize revenue over the life of the virtual good; however, D subsequently concludes that it cannot reliably estimate the life of each virtual good because each good is consumed by multiple gamers with dissimilar behaviors. In addition, D is unable to reliably estimate a gamer's life. Company D therefore concludes that it would be most appropriate to recognize revenue associated with the purchase of each virtual good over the estimated life of the game.

Gaming entities need to determine whether the virtual good or the gamer's overall gaming experience is the deliverable in the arrangement.

Challenges and Other Considerations

Determining the Deliverable and Commencement of Revenue Recognition

As mentioned above, gaming entities need to determine whether the virtual good or the gamer's overall gaming experience is the deliverable in the arrangement. Because this decision will affect the determination of the appropriate accounting policy, it should include careful consideration of the nature of all the virtual goods sold as well as any other pertinent facts and circumstances.

If the virtual good is deemed the deliverable in the arrangement, revenue recognition would commence when the gamer begins consuming the virtual good. However, if the overall gaming experience is deemed the deliverable, revenue recognition could begin as soon as the gamer purchases virtual currency (or directly purchases a virtual good). This is consistent with the view that when gamers purchase virtual currency (or directly purchase a virtual good), they have access to the virtual goods that may enhance their gaming experience. Once an entity determines that the ultimate deliverable in an arrangement is the overall gaming experience and commences revenue recognition on this basis, the entity would generally not be permitted to change its policy to another method unless there is a change in the facts and circumstances leading to the conclusion that the overall gaming experience is the deliverable.

Availability of Secondary Markets

Some gaming entities permit virtual goods or currency to be resold or otherwise transferred between gamers (although this practice is prohibited by many gaming entities). These sales may be facilitated by the gaming entities themselves or by third-party resellers. When revenue is recognized over the life of a virtual good, the existence of secondary markets may affect a gaming entity's ability to determine or estimate the period over which the benefits of a virtual good are consumed because the benefits may last longer than those consumed by the original purchaser. Similarly, the determination of a gamer's life may be influenced by the gamer's ability to trade virtual goods and currency on an open market, since this may alter the period during which a gamer continues to play a game.

In developing appropriate revenue recognition policies, gaming entities should consider the possibility that the benefits of virtual currency and virtual goods may be consumed by multiple gamers. This factor adds another layer of complexity to a gaming entity's ability to obtain sufficient historical information to support its accounting policy; gaming entities will need to factor this into existing data accumulation practices.

Virtual Currency and Breakage

The estimation of the amount of breakage and the period over which it should be recognized needs to be supported by sufficient historical evidence.

Gamers often use a gaming entity's own virtual currency to purchase virtual goods. This virtual currency is generally in proportion to the cash amount used to purchase it. For example, $1 may buy 10 virtual-currency credits, which can then be used to purchase various virtual goods (entities also sometimes offer volume discounts to gamers, such as $5 for 60 currency credits). As discussed above, when the virtual good (and not the gaming experience) is deemed to be the deliverable, it would not be appropriate to recognize revenue upon the sale of virtual-currency credits since the entity is still obliged to deliver the virtual goods that are ultimately purchased by a gamer. However, sometimes gamers do not ultimately redeem all available virtual-currency credits (often referred to as "breakage"). Entities generally use one of the following two approaches to recognize breakage:

- Breakage is determined on each gamer's available virtual currency and recognized when the gaming entity is legally released from its obligation to the gamer (e.g., the currency units expire or redemption of the virtual currency becomes remote).
- Breakage is recognized on an entire population of virtual currency to the extent that the currency is considered homogeneous. Such breakage is recognized in proportion to the recognition pattern of amounts redeemed for virtual goods if redemption of a certain amount of virtual currency is considered remote. Under this approach, the estimated value of virtual currency expected to go unused in a large homogeneous virtual-currency pool sold over a certain period would be recognized in proportion to actual redemptions for virtual goods (i.e., as the related revenue for the virtual good is recognized). To appropriately recognize revenue from breakage under this method, entities need to be able to reasonably and objectively determine the amount of breakage and the period over which, and policy under which, revenue is recognized.

In either scenario, the estimation of the amount of breakage and the period over which it should be recognized need to be supported by sufficient historical evidence that is representative of future outcomes and is not materially different from actual results.

Gross-Versus-Net Considerations

Third parties, such as social media Web sites and mobile platforms, are often an integral part of the online gaming business model because they provide gaming entities with access to a broad base of potential gamers. Such third parties typically process payments for the sale of virtual currency or goods by gaming entities. These third parties charge the gaming entity a fee for processing these microtransactions, which is normally calculated as a set percentage of the value of the transaction undertaken on their social or mobile platform. For example, a social media Web site may retain 30 cents for each dollar spent on a gaming entity's products and services, which are accessed through the social media Web site. Under these circumstances, an entity must determine whether it is the principal in the transaction or the agent so that it can appropriately present the transaction revenue on a gross or net basis.

Because an entity must use judgment when determining whether it is a principal or an agent, this area is heavily scrutinized. As described in ASC 605-45, an entity should consider certain factors when determining the appropriateness of gross or net presentation, including, but not limited to, which entity (1) is the primary obligor in an arrangement, (2) is involved in determining specifications for virtual products, (3) carries any inventory risk, and (4) has latitude in establishing price.

Although an entity would need to consider all such factors, ASC 605-45 indicates that the determination of the primary obligor and of the entity that carries inventory risk are strong indicators in the assessment of whether an entity is an agent or a principal and thus in the gross-versus-net conclusion. (These factors therefore are potentially more important than the others, although the consideration of inventory risk is generally not applicable in this industry.) This is consistent with our understanding of the SEC staff's view.

In the evaluation of arrangements under ASC 605-45, the gaming entity often is deemed to be the principal in the transaction. Revenue would therefore be reported on the basis of the gross amount paid by the gamers, and any difference between the reported amount and the actual consideration received would be reported as an expense paid to the agent in the transaction. In certain circumstances, it may be difficult for gaming entities to obtain sufficient information regarding the consideration received from the gamer to report revenue on a gross basis, in which case alternative reporting (e.g., on the basis of the consideration received from the agent) may be acceptable; however, entities should consult their accounting advisers before using an alternative reporting approach.

An entity must determine whether it is the principal in the transaction or the agent so that it can appropriately present the transaction revenue on a gross or net basis.

Example

Entity X, an operator of a social media Web site, processes payments for microtransactions involving the sale of virtual currency specific to Entity Y's freemium game. Entity Y receives a fixed amount from X for each unit of virtual currency sold on X's Web site. Further, Y is fully responsible for redeeming the virtual currency and providing the overall gaming experience and would be deemed the primary obligor in the arrangement. Therefore, after considering the other indicators in, and requirements of, ASC 605-45, Y concludes that it is the principal in the sales transaction with the gamer and is therefore required to report revenue from the transaction on a gross basis. That is, to the extent that information is available, revenue would be reported in Y's financial statements on the basis of the gross amount paid by the gamers to X and any difference between that amount and the consideration received from X would be reported as an expense paid to the agent in the transaction (X). Provided that Y has access to the necessary information to report in this manner, various challenges from an internal control perspective may also arise since Y would need to validate the completeness and accuracy of the amount that X received, particularly because this amount would be disclosed in its revenue.

The determination of gross-versus-net presentation is highly debated in the freemium gaming industry given the subjective nature of arriving at a conclusion and the complexities and factors involved in reporting revenue on a gross basis. Gaming entities will need to weigh all facts and circumstances in determining the appropriate presentation and recognition of revenue in these arrangements.

In assessing the identification of the primary obligor, an entity will need to consider whether it is responsible for fulfilling the obligation to the gamer, including ensuring the acceptability of the virtual goods that the gamer purchases. Representations made by a gaming entity during its marketing of the game and its virtual goods, together with the game's terms and conditions, may serve as evidence of whether the gaming entity or a third party is responsible for fulfilling obligations to a gamer. Other factors, such as identification of the entity that handles disputes with or queries from gamers (either technical or billing-related), may constitute further evidence of the primary obligor's identity.

Impact of Protective Terms and Conditions

The terms and conditions of many freemium games state that after providing a gamer with access to purchased virtual currency or goods, the gaming entity has no further obligation to the gamer, including providing refunds for purchases, even when the gamer's access to the virtual currency or goods is hindered or prevented. A question that often arises is whether these terms influence revenue recognition associated with the sale of virtual goods. Such protective terms are common in many industries and are generally implemented to safeguard companies against mass payouts in the event of circumstances beyond their control. However, because entities generally operate as a going concern and are economically compelled to continue to grant gamers access to purchased virtual goods or the ability to use virtual currency, these terms generally do not result in an acceleration of revenue recognition.

Free goods and services may pose additional challenges with respect to gaming entities' existing data accumulation practices.

Free or Discounted Virtual Goods

Occasionally, gaming entities provide gamers with free or discounted virtual goods or currency to entice them to continue playing the game or encourage them to purchase additional virtual goods or currency. Such offers may take various forms, including:

- Providing free virtual goods and currency to gamers each time they access a game or at regular set intervals.
- Distributing discount vouchers free of charge that can be redeemed when a virtual good is purchased.
- Offering free or discounted virtual goods as part of an existing sale of the gaming entity's virtual goods or as part of the purchase of the goods or services of a third party with whom the gaming entity may be affiliated.

ASC 605-50 provides guidance on accounting for cash incentives or free or discounted products provided to a customer, including when such items should be characterized as an expense or as a reduction of revenue. It also notes that a current sales transaction involving free or discounted goods or services that are redeemable by the customer as of a future date without a further exchange transaction would constitute a multiple-element arrangement (and would be accounted for under ASC 605-25). Therefore, gaming entities offering such incentives would need to consider the guidance in ASC 605-25 and appropriately allocate consideration received to each element in the transaction (i.e., the original good or service and any free or discounted goods or services).

Free goods and services may pose additional challenges with respect to gaming entities' existing data accumulation practices. In particular, gaming entities may need to distinguish between virtual goods or currency transferred for free or at a discounted amount and those transferred for full value to determine the appropriate revenue recognition policy.

Thinking Ahead

The FASB and IASB are currently finalizing a new converged revenue recognition standard. The new standard is expected to be released during the summer of 2013 and would be effective for reporting periods (fiscal and interim) beginning after December 15, 2016, for public companies. Nonpublic companies have the option to apply the standard at the same time or to defer adoption for an additional year. As a result, gaming entities may need to reconsider their current accounting policies for online games to ensure compliance with the new standard. Gaming entities that are currently developing revenue recognition policies for online games and the sale of virtual currency and goods may wish to understand the requirements of the revised standard so that they can potentially avoid further policy changes by aligning any existing accounting policies with those of the revised standard to the extent possible under current GAAP.

Appendix — SEC Comments

At the 2012 AICPA National Conference on Current SEC and PCAOB Developments, the SEC staff discussed the accounting for virtual goods, emphasizing that it has requested registrants in this industry to provide enhanced disclosures about their accounting policies, including all recognition and measurement assumptions used. These disclosures include (1) how customers acquire virtual goods; (2) the significant terms related to virtual currency, including processing fees and refund provisions; (3) how virtual-currency credits and processing fees are accounted for; (4) any regulatory or legal requirements to refund unused virtual currency and prepaid player balances; and (5) whether transactions are recorded on a gross or net basis.

Included below are certain comments that the SEC has issued registrants in the online gaming industry regarding their accounting policies for and disclosures about revenue earned from freemium games. These comments may be helpful to registrants that are currently developing accounting policies and disclosures related to transactions undertaken as part of a freemium gaming model and may provide some insight into some of the SEC's focus areas.

- "We note your disclosure on page [X] which indicates that you monetize social games, in part, through "microtransactions." Please describe these microtransactions, including the terms of any items purchased (e.g. time-based, usage-based, etc.), and the related revenue recognition policy."
- "Clarify how you recognize revenues for certain promotions to customers that include the sale of in-game virtual currency via the sale of a game card and also other deliverables such as a limited edition in-game virtual good."
- "Please revise your critical accounting policy for revenue recognition to describe in greater detail the significant estimates and assumptions that management makes in determining the average period that a paying player typically plays your games and the estimated average life of your virtual goods. In addition, revise your disclosures to discuss the estimates and assumptions that you consider in differentiating between revenues attributable to durable and consumable virtual goods. We refer you to Section V of SEC Release No. 33-8350."
- "Additionally, your response to prior comment [X] indicates that the microtransactions relate to the purchase of virtual goods associated with your social games and revenue is recognized once the customer purchases the virtual goods. Please provide additional details regarding these transactions including whether the virtual goods are consumed over time by the customer, have a limited life or are perpetual. In your response, please also tell us how you determined that immediate revenue recognition was appropriate including how you considered recognizing revenue as the item is consumed, over the life of the item or over the estimated life of the item or game if perpetual."
- "Please explain in greater detail how you determine the estimated average playing period for paying players and the estimated average life for durable virtual goods. As part of your response, please address the following:"
    - "Tell us how you determine when a paying player makes a purchase if you are not able to accurately quantify or estimate the number of paying players across all platforms in any period because you do not receive unique player data from all platforms used by players;"
    - "Clarify how you determine the ending date for purposes of calculating the estimated average playing period for paying players. Explain in greater detail how the ending date is calculated using the attrition rate for a given game by analyzing all paying players to determine whether each player within the analyzed population is an inactive or active player as of the date of your analysis;"
    - "Describe in detail any assumptions and estimates that you use to determine the estimated playing period for paying players and;"
    - "Explain why you believe it is reasonable to estimate the average playing period for new games launched with limited paying player data based on other recently launched games with similar characteristics. . . ."
- "Revise to explain how you account for unused virtual currencies of paying players that you determine are inactive. Clarify how you determine whether a paying player is inactive."

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