

**Electronic Arts Inc.  
Supplemental Information  
Revenue Recognition For Online-Enabled Packaged Goods  
February 1, 2007**

**Frequently Asked Questions (FAQ)**

**Background**

We are continuing to expand our online offering included in our packaged goods games and beginning in fiscal year 2008, we will not charge for the online hosting service.

Beginning in fiscal year 2008, for online enabled games on the PS3, PS2, PSP and PC, all package goods revenue will be amortized over the length of the online service period, which we currently estimate to be six months.

Given the significance of the holiday season, this means that likely more than \$400 million in revenue that would have otherwise been reported in fiscal year 2008 will now be deferred and recognized in fiscal year 2009. We do not intend to defer any product costs.

**It is important to keep in mind that this change:**

- Will not impact any of your estimates for fiscal year 2007.
- Does not in any way impact the economic fundamentals of our business.
- Will not adversely impact our cash flows; and finally
- Through our non-GAAP reporting, you will have comparability to prior periods to judge our performance.

**In short, a big change in our GAAP results for fiscal year 2008, but no change in the economics of our business, our cash flow or your ability to judge our performance.**

We made a few changes to our financial presentation this quarter. Most significantly, we added a line to our non-GAAP reconciliation where we plan to add or subtract the change in deferred revenue in order to determine our non-GAAP EPS.

**We have modified our non-GAAP measures for several important reasons:**

- To provide you with comparable year-over-year results. We do not intend to defer any of the product costs. As a result this one line item will normalize our year-over-year comparisons.

- To be more reflective of the cash characteristics of our business. Remember that the deferral of revenue does not adversely impact cash flow. The economics of the business will not change.
- This is how we will manage our business, assess our operating performance and measure management. We want our team focused on the consumer, improving cash generation and increasing our return on investment.

**In addition, if you go to our website you will see an expanded set of schedules and reconciliations that should also assist you in understanding the impact of this change and our other non-GAAP adjustments.**

## **Business Model**

### **What is changing?**

- With the global expansion of online gaming, more packaged goods games will be delivered with significantly enhanced online game play. Online game play will be a more integral part of next generation gaming.
- In fiscal year 2008 we will continue to expand our online offering and we will no longer charge for online hosting as it relates to our package goods titles.
- While we have explored various models in the past, we believe the best long-term opportunity for us is to provide these services free of charge to our consumers.

### **Why do you have to defer the revenue for the entire packaged goods game?**

- Under SOP 97-2 “Software Revenue Recognition”, for sales of software that are bundled with services, in order to recognize the revenue related to the software upon shipment, we must be able to allocate the sales price between the service and the software components.
- In order to allocate a portion of the sales price to the online service, the accounting rule requires us to have “vendor specific objective evidence” of fair value (“VSOE”) for the service. This essentially means we have to charge separately for the service in order to establish fair value.
- Since we are not going to charge for this service, we will no longer be able to allocate the value between the components; therefore, U.S. GAAP will require us to recognize the revenue for the entire game over the service period.

### **What platforms, titles and SKUs will be impacted by the change in business model in fiscal year 2008?**

- Beginning in fiscal year 2008, we anticipate that certain games with online game play for the PS3, PS2, PSP and PC will be impacted. In addition to certain of our catalog of previously-released SKUs.

**Do you have a list of titles that will be impacted in fiscal year 2008?**

- No. We anticipate providing more specific title information on our fiscal 2007 year-end earnings call.

**How will I be able to compare your fiscal year 2008 results to prior periods given the change?**

- Our non-GAAP measures will provide income statement comparability.
- In preparation for fiscal year 2008, we made a few changes to our financial presentation in Q307. Most significantly we added a line to our non-GAAP reconciliation where we plan to add or subtract the change in deferred revenue, beginning in fiscal year 2008, in order to determine our non-GAAP EPS. The addition of this one line item will provide year-over-year comparability.
- Our GAAP results for fiscal year 2008 will not be comparable to prior periods.

**Do you expect to revise your non-GAAP financial results for prior periods?**

- No. We expect that any changes we make to our non-GAAP financial measures will be done solely on a prospective basis beginning in the first quarter of fiscal year 2008.

**Do you have to defer revenue on an online enabled packaged good even if the consumer never plays online?**

- Yes, the same accounting applies regardless if the consumer actually plays online.

**How are you currently accounting for online services in packaged goods games?**

- We currently charge a fee for our online hosting service on selected SKUS for the PS2, PSP and PC.
- This establishes the fair value of the online hosting service.
- Going forward we do not plan to charge.

**Why does the charging model not work going forward?**

- The challenge we have been facing is how to optimize the consumer experience and expand our online service offering for online enabled

packaged goods, but at the same time navigate the complexities of SOP 97-2, "Software Revenue Recognition".

- The model we have been using is cumbersome and we don't believe is a long-term solution. In addition, it is less desirable for the consumer, so effective next fiscal year EA will no longer charge.
- This change is about putting the consumer first and letting the accounting follow.

### **What specific online service does EA provide?**

- EA provides an online community for our games in which we match gamers, track their stats, host tournaments, provide chat services and offer additional content such as live sports feeds and strategy updates.

### **Are the Xbox 360 or Xbox titles impacted?**

- Package goods revenue associated with the Xbox 360 and Xbox will not be impacted in large part because Microsoft charges for its online service. As a result – we expect no change from current practice.

### **Does EA expect to provide online hosting services for the Nintendo platforms?**

- Our revenue recognition will be dependent upon the ultimate online service offering on the Nintendo platforms.

### **Does EA expect to provide online hosting services for the Sony platforms?**

- Currently, EA is providing the online hosting services for the PS3, PS2 and PSP.
- While we can't speak for Sony, they are currently not charging for this service.

## **Financial Impact**

### **How does this impact the revenue recognition for a SKU?**

The following example helps illustrate the financial impact of deferred revenue on a single SKU with free online hosting services included in a packaged good sale:

*Hypothetical Fact Pattern (for illustrative purposes only):*

Assume EA sells one million copies of a game for the PS2 in April 2007 at an average wholesale price of \$40 per unit. Also assume that revenue reductions (e.g., price protection and sales return charges) are equal to 10% of wholesale revenue.

Under the new business model, 100% of the revenue and the related revenue reduction for the packaged goods sale would be deferred and amortized ratably over the estimated six-month service period.

Example:

**FY08 Model**

100% deferral of revenue and revenue reductions, amortized over six months

Amounts in thousands (000s)

**Statement of Operations:**

	Apr	May	Jun	Jul	Aug	Sep	Oct	Total
Revenue:								
Gross revenue	40,000	-	-	-	-	-	-	40,000
100% deferral	(40,000)	-	-	-	-	-	-	(40,000)
Amortization	-	6,667	6,667	6,667	6,667	6,667	6,667	40,000
Revenue reductions:								
Gross reduction	(4,000)	-	-	-	-	-	-	(4,000)
100% deferral	4,000	-	-	-	-	-	-	4,000
Amortization	-	(667)	(667)	(667)	(667)	(667)	(667)	(4,000)
Net revenue	-	6,000	6,000	6,000	6,000	6,000	6,000	36,000

**Balance sheet:**

Deferred net revenue	36,000	30,000	24,000	18,000	12,000	6,000	-
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**How does the revenue deferral impact cash flows?**

- Cash flows will not be adversely impacted.
- We will continue to collect receivables from our customers in the ordinary course of business; however, the timing of recognizing the related revenue will change.

**How does the revenue deferral impact EA's sales returns and price protection charges?**

- For the SKUs impacted, sales returns and price protection charges will be deferred and recognized ratably over the estimated service period.
- The charges will be recognized over the same period as the associated revenue.

**When will EA start recognizing the revenue for an online-enabled packaged goods SKU?**

- For SKUs subject to deferred revenue recognition, we anticipate that we will recognize 1/6th of the revenue in the month **after** shipment.

**If the consumer is receiving the service, shouldn't you defer revenue recognition until the unit has sold through to the consumer?**

- Our approach of recognizing the revenue ratably over six months beginning in the month after the initial sale to the retailer is intended to reflect the amount of time it takes an average unit to sell through to the consumer.

**How will cost of goods sold be impacted?**

- There is no impact to cost of goods sold.
- We do not intend to defer the product costs (inventory cost, packaging, freight, warranty, console royalties, licensing royalties, etc.) associated with the SKU because title for the inventory has passed to the retailer. Once title has passed and the retailer has assumed physical risk for the inventory, we believe it is appropriate to recognize (rather than defer) the costs.

**How will gross margins be impacted?**

- EA will not defer the product costs (inventory cost, packaging, freight, warranty, console royalties, licensing royalty rates, etc.) associated with the SKU because title for the inventory has passed to the retailer.
- As a result, this change will contribute to wide variations in our reported GAAP margins.
- Our non-GAAP measures will provide income statement comparability. In preparation for fiscal year 2008, we made a few changes to our financial presentation in Q307. Most significantly we added a line to our non-GAAP reconciliation where we plan to add or subtract the change in deferred revenue, beginning in fiscal year 2008, in order to determine our non-GAAP EPS. The addition of this one line item will provide year-over-year comparability.

**How will income taxes be impacted?**

- Our fiscal year 2008 effective income tax rate will be impacted by this change.
- We will provide more information on our fiscal 2007 year-end earnings call.

## **Important Reminder About Forward-Looking Statements**

*Some statements set forth in this document, including estimates relating to the financial impact of the Company's changing business model for online services, contain forward-looking statements that are subject to change. Statements including words such as "anticipate", "believe", "estimate" or "expect" and statements in the future tense are forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause actual events or actual future results to differ materially from the expectations set forth in the forward-looking statements. Some of the factors which could cause the Company's results to differ materially from its expectations include the following: the availability of an adequate supply of current-generation and next-generation hardware units (including the Microsoft Xbox 360, Sony PlayStation 3 and Nintendo Wii); the Company's ability to predict consumer preferences among competing hardware platforms; consumer spending trends; the seasonal and cyclical nature of the interactive game segment; timely development and release of Electronic Arts' products; competition in the interactive entertainment industry; the Company's ability to attract and retain key personnel; changes in the Company's effective tax rates; adoption of new accounting regulations and standards; potential regulation of the Company's products in key territories; developments in the law regarding protection of the Company's products; fluctuations in foreign exchange rates; the Company's ability to secure licenses to valuable entertainment properties on favorable terms; and other factors described in the Company's Annual Report on Form 10-K for the year ended March 31, 2006 and Quarterly Report on Form 10-Q for the quarter ended September 30, 2006. These forward-looking statements speak only as of February 1, 2007. Electronic Arts assumes no obligation and does not intend to update these forward-looking statements.*