



Accounting FAQ

LAST UPDATED FISCAL 2018 Q4

About this document

The purpose of this document is to clarify accounting topics specific to Electronic Arts and the videogame industry. We also highlight how our accounting treatment may vary from our peers in effort to help the investment community when reviewing the industry as a whole.

This document is intended to increase general understanding of EA's business and financial results. As such, we have summarized select accounting policies in the answers below. This is not intended to be a definitive list of all investor questions or all material accounting policies. Please refer to our SEC filings for information regarding the topics discussed below for a full discussion of our accounting policies.

General Accounting Considerations

Why do you report *net* revenue, specifically?

Similar to many companies, we report a majority of our revenue as “net revenue” as opposed to “gross revenue”. Gross revenue is the revenue from an initial sale to a digital marketplaces or retail before factoring in any standard deductions, such as allowances, platform provider fees, discounting and so on. Net revenue is the amount recognized after taking into account the above factors. We believe reporting net revenue is a more meaningful disclosure because it reflects the amount we ultimately recognize as revenue.

Why do you defer revenue from full game sales and extra content?

GAAP reporting requires us to defer and recognize much of our revenue from game sales over a period of time. This is driven by the online nature of our games. For example, a customer may buy a copy of Madden NFL with the expectation that they will play online against their friends. We therefore have a responsibility to provide that service – the ability to play online – for a period of time. Similarly, we may update our games with new content for no additional fee and our customer would have rights to that update. Consequently, U.S. GAAP requires us to recognize revenue over the period we anticipate providing services and updates. A general rule of thumb is that, for digital goods, (for example, purchasing and downloading Madden NFL from the Microsoft Xbox Store), we recognize revenue over six months. For physical goods (selling Madden NFL to a brick and mortar retailer), we assume the game will spend time in the retail channel and we recognize revenue over nine months.

Exactly how much revenue is deferred has recently changed for FY19 (see the section on ASC 606 below). But the underlying principal remains consistent - we will continue to defer a portion of our revenue under U.S. GAAP. As a result, the quarter in which we sell the most games may be different from the quarter in which we recognize the most revenue. Further, because we recognize the costs associated with selling the games as they are incurred, but the revenue over a period of time, the seasonality in our GAAP profits may appear counterintuitive. For example, historically we have reported a GAAP loss in the December quarter despite experiencing strong sales, and GAAP income in the June quarter, despite much lower sales.

Our deferred net revenue balance is increased by the revenue being deferred for current sales and is reduced by the recognition of revenue from prior sales (this is referred to as the “net change” in the deferred revenue balance). Given the seasonal nature of our business, the net change in the deferred balance is often material. Our sales have historically been highest in the December quarter (due to our release slate and the holidays), and so the deferred net revenue balance generally increases significantly in that quarter. Similarly, because sales have historically been lowest in the June quarter, the deferred net revenue balance generally decreases significantly in that quarter.

Under U.S. GAAP, all video game companies may be required to defer a portion of revenue for games with online gameplay, but the deferral amount and recognition period may be different amongst companies.

How do you recognize revenue from subscription services?

We recognize revenue from our subscription services ratably over the subscription contract. There is no difference between our GAAP treatment and net bookings treatment of subscription services revenue.

What is net bookings?

Net bookings is the total amount of goods and services sold in the period. It can be calculated by adding total net revenue to the change in deferred net revenue for online-enabled games and, for periods after the fourth quarter of fiscal 2018, mobile platform fees. Note that we have expressed the mobile platform fees as a negative number, reflecting the fact that this is the share taken by the mobile platform provider. We believe net bookings tracks cash flow more closely than net revenue, and consequently, is an operational metric our management team uses internally to analyze the performance of our business. Many financial analysts calculate this metric to make comparisons with prior periods and with our peers.

Do you capitalize game development costs?

No. We generally expense research and development costs associated with our games and services as incurred.

This treatment varies from some of our peers who capitalize and amortize these costs.

Impact of ASC 606

What is ASC 606?

ASC 606 is the new revenue standard under U.S. GAAP accounting. We adopted ASC 606 at the beginning of our fiscal 2019 year, which began April 1, 2018.

How does the new standard impact Electronic Arts revenue?

It will affect our GAAP revenue, but it will not materially impact net bookings, our operational metric. Our management team will continue to focus on net bookings to run the business.

Under ASC 606, we anticipate GAAP revenue will be closer to net bookings. This is because we will generally be able to recognize more revenue at the time of the initial sale for games that can be played offline.

Under ASC 605, we were generally required to ratably recognize all of the revenue from a sale of a game that can be played either offline or online over six or nine months. Under ASC 606, the sales price for these games are divided up between the average value of the software itself, the value of the updates and of the online hosting. The value of the software is recognized as revenue immediately at the time of sale, with the remaining amount recognized ratably over six months for digital goods or nine months for physical goods. As a result, we will defer less revenue than we historically did under the previous revenue standard.

Other videogame companies may use a different revenue split between immediate and deferred revenue as well as a different time frame to recognize the deferred portion of revenue.

Will ASC 606 change how you report mobile revenue?

Yes, for GAAP reporting, and as a result of ASC 606, at the beginning of FY19 we will begin reporting most mobile revenue on a gross basis. Currently, mobile platform fees retained by third-parties, such as Apple and Google, are reported on a net basis, within net revenue. Beginning in FY19, we will report most mobile platform fees within cost of revenue. As a result, both mobile revenue and cost of revenue will increase by the amount of these mobile platform fees. In our FY19 guidance, we have quantified expected mobile platform fees to allow you to calculate revenue and net bookings in a way that is comparable to prior periods.

We made this reporting change because ASC 606 changes the criteria used to determine whether a third-party partner (such as Apple through their App Store) is an “agent” or a “principal”. For EA, this changes how the fee retained by the third-party partner is presented in EA’s financial statements (i.e., as a cost of sale instead of as a reduction of revenue).

This change only affects revenue through Apple and Google, and not from other sources such as mobile advertising.

This reporting change does not impact our net bookings metrics.

Does the new revenue standard change the way you classify net bookings?

We will not change our net bookings categories but will make some minor adjustments to the classifications.

Under ASC 606, we are able to allocate a sale to different net bookings categories. The primary example is a game that includes extra content – we call this a “bundle”. Under the previous standard, we did not, under certain circumstances, allocate value to the components of the bundled sale, hence the entire amount was classified as a full game net booking, even though it technically included extra content. Under ASC 606, we will allocate the value between full game net bookings and extra content net bookings. The update will not change the total net bookings amount recognized but will change the mix between the categories (we anticipate more extra content and less full game).

Will ASC 606 impact gross margin?

We anticipate a slightly dilutive impact to GAAP gross margin due to the change in the way we recognize mobile revenue and related mobile platform fees (from net to gross, as discussed above). However, there will not be a material impact to management reporting.

Will there be a material effect on your cash flow?

Upon adoption of ASC 606, we will accelerate the revenue recognition on prior period game sales into retained earnings. This will result in one-time cash tax impact.

When will Electronic Arts incorporate ASC 606 into its financial statements?

We provided FY19 guidance under the new revenue standard on the May 8, 2018 earnings call and will begin reporting revenue under the new revenue standard in Q1 FY19 (quarter ending June 30, 2018).

How will Electronic Arts incorporate ASC 606 into its financial statements?

We have chosen to adopt ASC 606 using the modified retrospective approach, which means that we will not restate our historical financial statements. For comparability, in our SEC Filings, we will also report pro-forma financial results during FY19 under ASC 605, which will provide the ability to compare FY19 financial results to FY18 financial results.

Where can I find additional information about Electronic Arts' adoption of ASC 606?

Our Form 10-Q for the quarter ended December 31, 2017, contains additional information regarding the adoption of ASC 606 under the heading "Impact of Recently Issued Accounting Standards". We expect to update this information in our FY18 Form 10-K, which we anticipate filing in May 2018.

Forward-Looking Statements

Some statements set forth in this document 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 preliminary estimates and expectations based on current information and are subject to business and economic 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.

These forward-looking statements are current as of May 8, 2018. The select information provided herein does not purport to be complete and is qualified in its entirety by reference to the Company's SEC filings. Please refer to the Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2017 for information regarding the Company's accounting policies. In addition, the preliminary conclusions set forth in this document are estimates based on information currently available to

Electronic Arts. Electronic Arts assume no obligation and does not intend to update these estimates prior to filing its Annual Report on Form 10-K for the fiscal year ended March 31, 2018.