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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**19 April 2007, London**
Project:	**Annual Improvements process**
Subject:	**IAS 38 *Intangible Assets* – Advertising and promotional activities (Agenda paper 7)**

1. The IFRIC has recommended that the following issue would be most appropriately resolved via the annual improvements process (as agreed by the Board in July 2006).

   Issue: Should IAS 38 *Intangible Assets* be amended to make clear at what point training and advertising and promotional expenditure should be recognised as an expense?

Recommendation

2. At its meeting in March 2007, the IFRIC asked the staff to recommend to the Board that:

   - the Board add the issue described in paragraph 1 to the annual improvements project;
   - IAS 38 be amended to state that payments made in respect of training or of advertising and promotional activities may be recognised as an asset in the balance sheet until such time as those activities first take place; and

- SIC 32 *Web Site Costs* be amended to make it consistent with the changes proposed.

Background

3. The IFRIC received a request for guidance as to how an entity should account for costs incurred in developing and producing catalogues and TV advertising spots. Divergent practice had been identified with some entities accounting for such costs as an expense as incurred, some as an expense when the catalogues were distributed or TV spots screened and some recognising an intangible asset and amortising it over the period in which the TV spots or catalogues were expected to generate sales.

4. The IFRIC considered that producing an Interpretation on the accounting for catalogues would be too narrow and so decided to consider the wider question of the accounting for advertising and promotional expenditure.

5. IAS 38.68 states that expenditure on an intangible item shall be recognised as an expense when it is incurred unless it is either acquired in a business combination or it meets the recognition criteria set out in paragraphs 18-67 of IAS 38.

6. IAS 38.69 states that 'examples of expenditure that is recognised as an expense when it is incurred include…expenditure on training activities [and] expenditure on advertising and promotional activities.'

7. IAS 38.70 states 'Paragraph 68 does not preclude recognising a prepayment as an asset when payment for the delivery of goods or services has been made in advance of the delivery of goods or the rendering of services.'

8. The IFRIC considered that it was clear that paragraph 70 allows an entity to recognise a prepayment in situations where it has paid for goods or services but has not yet received those goods or services. However, the IFRIC considered that there was ambiguity over whether paragraph 70 required an entity to cease capitalisation (and recognise an expense) when the goods or services are received by the entity or, alternatively, when they are received by the entity's customers.

IFRIC Consensus

9. The IFRIC first agreed that an entity may recognise a prepayment <u>only</u> until that entity receives the related goods or services. The IFRIC therefore proposed that paragraph 70 should be amended to make clear that a prepayment may be recognised by an entity only until that entity receives the related goods or service.

10. The IFRIC then considered the treatment of the costs of these goods or services between the point at which the entity received them and the point at which it used them (for example by distributing the advertising to its customers). The IFRIC concluded that costs associated with advertising and promotional activities may be held in the balance sheet during this period as they represent a future economic benefit to the entity.

11. The IFRIC therefore proposed adding a further sentence to paragraph 70 stating that payments in respect of future advertising and promotional activities may be recognised as an asset until such time as those activities first take place.

12. The IFRIC noted that IAS 38.69 also applies to expenditure incurred for certain other items including training activities, start-up activities, and expenditure on relocating or reorganising part or all of an entity. The IFRIC agreed that considering all of these items was beyond the scope of its project. However, the IFRIC also considered that the issues concerning the deferral of expensing training expenditure were so similar in nature to those concerning advertising and promotional expenditure that it was difficult to justify a different accounting treatment.

13. Whilst the IFRIC agreed that its proposed limitation on the recognition of prepayments beyond the point at which an entity received goods or services should apply to all of the activities discussed in paragraph 69, it also agreed that its proposed amendment in respect of the recognition of an asset in the period between the receipt and the use of the goods or services should be limited to training or advertising and promotional activities.

14. The majority of IFRIC members supported these changes. However, a minority believed that the changes should not be made. Supporters of the view that no changes should be made noted that:

(a) the changes are not principle based, and instead introduce an arbitrary exception to a rule within the standard;

(b) if an asset is recognised until advertising or promotional activities take place, it is not clear how such an asset will be tested for impairment. In particular, it is not clear how future cash flows associated with that asset can be separately identified;

(c) the exception to the rule is not consistently applied since it applies to some, but not all, of the items in paragraph 69. In particular, it is difficult to see why start-up activities attract a different accounting treatment to advertising and promotional activities when many start up activities are also advertising and promotional activities;

(d) carrying an asset in respect of training or advertising and promotion expenditure is not consistent with not recognising an asset for an assembled workforce or internally generated brand; and

(e) mail-order catalogue companies which have previously capitalised and amortised expenditure for the production of a catalogue over the periods in which it is expected to generate sales have justified this treatment on the basis that mail-order catalogues are not advertising and promotion. The changes proposed by the IFRIC will not address the question as to whether catalogues are advertising and promotional items and so will not address the divergence which gave rise to the initial submission to the IFRIC.

15. Despite these objections, the majority of IFRIC members believed that the changes should be made. In particular these members noted that:

(a) paragraph 69 of IAS 38 already introduces a rule into the standard. The proposed change is only intended to refine that rule in respect of some items in order to bring their treatment closer to the principles identified in IAS38. It does not therefore make the standard any less principle-based;

(b) the asset which exists until the advertising and promotional activity is undertaken is the ability to make use of that advertising or promotion. Entities will be able to test for impairment by assessing whether they have the ability to use that asset to avoid future outflows and whether it is valuable to them. Entities should therefore be able to apply existing guidance to test such assets for impairment;

(c) the changes to the rule are not applied to all of the items in paragraph 69 as they were outside of the scope of the IFRIC's work and as divergence had not been identified in these areas; and

(d) an asset in the form of a 'trained workforce' or 'brand' is created or enhanced when the training or advertising and promotion takes place. That asset is a different asset from the ability to undertake future training or advertising and promotional activities which exists before those activities take place. The fact that a workforce or brand does not meet the recognition criteria for an intangible asset does not therefore imply that the ability to undertake the future training or advertising and promotional activities does not meet the recognition criteria in IAS 38.

Staff Analysis

16. The staff considered that in order to reflect the IFRIC's proposed changes to IAS38.70, it is also necessary to amend paragraphs 68 and 69 to be clear that training and advertising and promotional expenditures are not required to be accounted for 'as incurred'. The staff has therefore drafted additional changes to those paragraphs and includes those changes in the proposed amendment set out below.

17. The staff notes that the revised wording is not intended as a major change to the standard but is instead intended to clarify that entities may recognise an asset in respect of training or advertising and promotional activities until such activities take place.

18. The consequence of this change will be that entities (and jurisdictions) that have previously believed that the current wording does not allow for the carry-forward of an asset beyond the point at which an entity receives the related

goods or services will now be able to recognise such expenditure as assets until training or advertising and promotional activities take place.

19. The staff notes that the proposed solution does not address all of the issues inherent in IAS 38. Instead, it represents the best solution to the issues identified by the IFRIC that can be achieved without making wholesale changes to the standard.

20. Whilst the staff has significant reservations about making this change and the fact that it may be seen as creating a list of rules which are applied to a selection of activities, the staff considers that it is the best way that the wording can be changed to reflect the IFRIC's wishes within the confines of the Annual Improvements Project.

21. The staff therefore recommends this change to the Board.

Recommendation

22. The staff recommends that IAS 38 *Intangible Assets* is amended as proposed below. Furthermore, the staff recommends that SIC 32 Web Site Costs is amended for consequential amendments as proposed below.

23. **Does the Board agree with the staff's recommendations?**

Drafting

24. The staff recommends that the following amendments should be made to paragraphs 68 and 70 of IAS 38 *Intangible Assets*.

Recognition of an expense

68 **<u>Subject to paragraph 70,</u> ~~E~~<u>e</u>xpenditure on an intangible item shall be recognised as an expense when it is incurred unless:**

(a) **it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 18–67); or**

(b) **the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, this expenditure (included in the cost of the business combination) shall form part of the amount attributed to goodwill at the acquisition date (see IFRS 3).**

69 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, except when it forms part of the cost of a business combination, expenditure on research is recognised as an expense when it is incurred

(see paragraph 54). Other examples of expenditure that is recognised as an expense when it is incurred include:

(a) expenditure on start-up activities (ie start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with IAS 16. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) or expenditures for starting new operations or launching new products or processes (ie pre-operating costs).

(b) ~~expenditure on training activities.~~ [Deleted]

(c) ~~expenditure on advertising and promotional activities.~~ [Deleted]

(d) expenditure on relocating or reorganising part or all of an entity.

70 Paragraph 68 does not preclude an entity's recognising a prepayment as an asset when payment for the delivery of goods or services has been made in advance of the delivery of goods or the rendering of services to that entity. Similarly, it does not preclude an entity's recognising as an asset payments made in respect of future training or advertising and promotional activities until the date on which those activities first take place.

25. The staff recommends that the following consequential amendments should be made to paragraphs 8 and 9, of SIC-32 *Web Site Costs*, paragraphs 14 and 16 of the Basis for Conclusions on SIC-32, and the Appendix to SIC-32.

Note: For the purpose of this paper, all proposed changes to SIC-32 have been highlighted. Where underlining or strike-through exists in the current text, this has been left in place, but is not highlighted.

SIC Interpretation 32
Intangible Assets—Web Site Costs

References

- IAS 1 *Presentation of Financial Statements* (as revised in 2003)
- IAS 2 *Inventories* (as revised in 2003)
- IAS 11 *Construction Contracts*
- IAS 16 *Property, Plant and Equipment* (as revised in 2003)
- IAS 17 *Leases* (as revised in 2003)
- IAS 36 *Impairment of Assets* (as revised in 2004)
- IAS 38 *Intangible Assets* (as revised in 20048)
- IFRS 3 *Business Combinations*

8 A web site arising from development shall be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in IAS 38.21 for recognition and initial measurement, an entity can satisfy the requirements in IAS 38.57. In particular, an entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits in accordance with IAS 38.57(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed.

An entity is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site shall be recognised as an expense when the web site is first made available to the public ~~incurred~~.

9 (c) expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products), shall be recognised as an expense when the content is first displayed on the web site ~~incurred~~ in accordance with IAS 38.70~~69(c)~~. For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, an entity shall recognise expenditure ~~shall be recognised~~ as an expense ~~as the professional services are received during the process, not~~ when the digital photographs are displayed on the web site.

Basis for Conclusions

[The original text has been marked up to reflect the revision of IAS 16 in 2003, ~~and~~ the subsequent issue of IFRS 3, and the revision of paragraph 70 of IAS 38 in 2008: new text is underlined and deleted text is struck through. Proposed changes have also been highlighted for clarity. This highlighting will be removed from any final published document.]

14 IAS 38.57~~45~~ requires an intangible asset arising from the development phase of an internal project to be recognised only if an entity can demonstrate fulfilment of the six criteria specified. One of the criteria is to demonstrate how a web site will generate probable future economic benefits (IAS 38.57~~45~~(d)). IAS 38.60~~48~~ indicates that this criterion is met by assessing the economic benefits to be received from the web site and using the principles in IAS 36 *Impairment of Assets*, which considers the present value of estimated future cash flows from continuing use of the web site. Future economic benefits flowing from an intangible asset, as stated in IAS 38.17, may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. Therefore, future economic benefits from a web site may be assessed when the web site is capable of generating revenues. A web site developed solely or primarily for advertising and promoting an entity's own products and services is not recognised as an intangible asset, because the entity cannot demonstrate the future economic benefits that will flow. Consequently, all expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when the web site is first made available to the public ~~incurred~~.

16 IAS 38.70~~69~~57~~(c)~~ requires expenditure on advertising and promotional activities to be recognised as an expense when the advertising or promotional activities first take place ~~incurred~~. Expenditure incurred on developing content that advertises and promotes an entity's own products and services (eg digital photographs of products) is an advertising and promotional activity, and consequently recognised as an expense when the advertising first takes place, ie when the content is first displayed on the web site ~~incurred~~ ~~in accordance with IAS 38.57(c)~~.

Appendix to SIC-32

This appendix is illustrative only and does not form part of the Interpretation. The purpose of the appendix is to illustrate examples of expenditure that occur during each of the stages described in paragraphs 2 and 3 of the Interpretation and illustrate application of the Interpretation to assist in clarifying its meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

Example application of SIC-32

Stage/nature of expenditure	Accounting treatment
Content development	
• creating, purchasing, preparing (eg creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. Examples of content include information about an entity, products or services offered for sale, and topics that subscribers access	Recognise as an expense when the content is first displayed on the web site ~~incurred~~ in accordance with IAS 38.70~~69(c)~~ to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products). Otherwise, recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in IAS 38.21 and IAS 38.57[(a)]
Other	
• selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use to operate in the manner intended by management	Recognise as an expense when incurred in accordance with IAS 38.65–.70
• clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance [eg false start testing]	
• training employees to operate the web site	Training of employees to use the web site should be recognised as an expense at the point at which the training is delivered to the employees in accordance with IAS 38.70.

(a) All expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when the web site is first made available to the public ~~incurred~~ in accordance with IAS 38.70~~68~~.

Basis for Conclusions on proposed amendments to IAS 38 *Intangible Assets* and SIC 32 Web Sit Costs

Training or Advertising and Promotional Activities

BC1 The Board noted that paragraph 70 of IAS 38 allows entities to recognise as a prepayment a payment for the delivery of goods or services when it has been made in advance of the delivery of those goods or services. There is diversity in practice as to whether this requirement refers to the delivery of goods or rendering of services to the entity or to its customers. The Board therefore decided to propose amendments to paragraph 70 to make clear that an entity may recognise a prepayment as an asset only until it has received the related goods and services and may recognise as an asset payments made in respect of future training or advertising and promotional activities until those activities first take place.