30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

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:	**15 May 2007, London**
Project:	**Annual Improvements Process**
Subject:	**Advertising and Promotional Expenditure (Agenda paper 5A)**

BACKGROUND

1. At its April meeting, the Board discussed a staff paper which proposed amending IAS 38.69-70 in respect of the accounting for advertising and promotional activities. The changes had originated from a recommendation by the IFRIC and were proposed as part of the Annual Improvements Process.

2. At that meeting, the Board was unable to reach consensus on the proposed changes and asked the staff to develop a paper considering how such costs should be accounted for.

3. This paper sets out the staff's proposals as to how such expenditure should be accounted for. In doing so, it considers separately expenditure to develop content (for example hiring models or actors) and expenditure to communicate the content (for example TV slots or airtime). It also considers accounting for situations in which an entity pays in advance for goods or services, and in which circumstances it may be appropriate for an entity to recognise a prepayment.

4. The paper focuses on the treatment of advertising and promotional expenditure. However, it also asks the Board whether any conclusions in respect of

advertising and promotional activities should be extended to apply to training activities, start-up activities, or other activities undertaken by an entity.

5. In keeping with the Board's discussions in April, this paper does not recommend any changes to the wording in IAS 38 but instead focuses on what the appropriate accounting treatment should be. If the Board agrees with the staff's proposals as to when an expense should be recognised, then the staff will develop wording changes to present to the Board.

RECOMMENDATION

6. The staff recommends that:

- costs of materials or services used to develop advertising and promotional content should be recognised as an expense as those materials or services are consumed by the entity;
- costs of materials or services used to communicate and develop advertising and promotional content should usually be recognised as an expense as the related goods or services are received by the entity performing the advertising. The only exception to this may be if those materials or services have an alternate use and, if acquired for that alternative use, would qualify for recognition as an asset under IFRS. Where this is the case, the costs should be recognised as an expense when the materials or services can no longer be used for that alternative purpose and can only realistically be used for advertising or promotional activities;
- these principles should be extended to apply to all expenditure on goods or services which are to be used to create or enhance an intangible asset which does not meet the recognition criteria (including spend on training and start-up activities); and
- IAS 38.70 should be amended to make clear that an entity may only recognise a prepayment until that entity has received the related goods or services.

7. The staff also recommends that these changes be made as part of the Board's Annual Improvements Process.

STAFF ANALYSIS

8. The staff has undertaken initial analysis using the example of a TV advertisement. For illustration, a summary of the activities undertaken in this example and a timeline is included in attachment 1 to this paper.

Content communication

9. The staff first considered costs associated with communicating the advertising and promotional content.

10. In the example in attachment 1, on 1 December, the entity enters into a contract with a TV broadcaster. On 1 January, it pays CU 300 for 3 advertising slots (at CU 100 per slot). The entity is responsible for preparing the content for the advertisements and delivering it to the TV broadcaster. The slots will be aired on 1 April, 1 May, and 1 June.

11. In the period between payment on 1 January and the date on which the TV slots are first aired on 1 April, the entity has a right to 3 TV slots. When the first is aired on 1 April, the entity will still have the right to the remaining 2 TV slots. The entity will have the right to the final TV slot until it is aired on 1 June.

12. The entity can sell the right to use the TV slots up to the point at which they are aired. Similarly, if the TV broadcaster decides to change the scheduling so that the entity can no longer use the slots, then the entity will be able to seek a refund for its payment.

13. Paragraph 89 of the Framework states that:

    An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

14. The staff considers that, before a TV slot has been aired, it is probable that future economic benefits will flow to the entity. These benefits may take the form of a cash refund if the slot is not aired, cash proceeds if it is sold, or the receipt of a valuable service (the airtime to show the entity's content). The cost of the future economic benefits can be reliably measured (in the example in this paper, the cost is CU 100 per slot).

15. The staff therefore considers that the un-aired slots are an asset of the entity that meet the recognition criteria.

16. Paragraph 97 of The Framework states:

An expense is recognised immediately in the income statement when an expenditure produces no future economic benefits or when, and to the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the balance sheet as an asset.

17. The staff considers that, when it is aired, the slot will create or enhance a brand or customer relationship intangible asset. The economic benefits created by that brand or customer relationship will be increased sales and therefore increased cashflows to the entity. The airing of the advertisement can be considered to be subsequent expenditure on that unrecognised intangible asset.

18. The staff therefore concludes that an entity may recognise a prepayment in respect of slots which have not yet been aired. Once those slots are aired, the entity should cease to recognise a prepayment. At that point, the entity should consider whether it is appropriate to recognise another type of asset that has been created or enhanced by airing the advertisement. As the only asset that will exist after the airing of the slots is an internally generated customer relationship or brand which does not qualify for recognition under IAS 38, the staff considers that the expense should be recognised at that point.

19. In the example in attachment 1, the entity should therefore:

- Recognise a prepayment of CU 300 from 1 January to 31 March
- On 1 April recognise an expense of CU 100
- From 1 April to 30 April continue to recognise a prepayment of CU 200
- On 1 May recognise an expense of CU 100
- From 1 May to 31 May continue to recognise a prepayment of CU 100
- On 1 June recognise an expense of CU 100
- Recognise no further asset beyond 1 June

Does the Board agree with this proposal?

Development of advertising content

20. The staff next considered at what point costs incurred developing advertising and promotional content should be recognised as an expense.

21. Attachment 1 shows an example in which an entity enters a contract on 1 December for the development of an advertisement. The entity pays CU 100 on 1 January to an agency which will develop the content. On 1 Feb, the agency undertakes scripting. On 10 February, it films the actor, and on 20 February it completes production. On 1 March, it delivers the final result to the entity by way of a video tape. The entity uses the video tape to screen the advertisement 3 times, once on 1 April, once on 1 May, and once on 1 June. The entity receives the benefit of airing the advertisement (by way of increased sales) over the 6 months commencing 1 April. For the purposes of this paper, the staff has assumed that the entity has widespread past experience which can demonstrate that sales increase following the airing of such advertisements.

22. The staff considers that there are a number of possible points at which an expense could be recognised including:

    (a) 1 January – the day on which the entity pays for the services in advance.

    (b) As the production company completes its work between 1 February and 20 February – that is, as the services are provided. An element of the cost would then be recognised as an expense on each of 1 February, when scripting takes place, 10 February, when filming takes place, and 20 February, when production takes place.

    (c) 1 March – the date on which the entity receives the advertising and promotional materials.

    (d) 1 April – the date on which the advertising and promotion materials are first used (this is in line with the IFRIC's original proposal).

    (e) A third each on 1 April, 1 May, and 1 June - this approach would match the recognition of the expense with the use of the advertising and promotional materials.

    (f) On a straight line basis over the 6 months commencing 1 April - this approach would match the recognition of the expense with the expected consumption of the economic benefit of the advertising – ie the increase in sales.

23. Paragraphs 89-90 of the Framework state:

An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. Instead such a transaction results in the recognition of an expense in the income statement. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits for the entity or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the entity beyond the current accounting period is insufficient to warrant the recognition of an asset.

24. The staff considers that, between 1 January and 1 March, the entity will expect with a reasonable degree of certainty that a future economic benefit will flow to it. This will be the receipt of the advertising materials.

25. The staff therefore considers that, until 1 March, the entity has an asset in that it has a right to the future economic benefit associated with receiving the advertising or promotional materials.

26. On 1 March, the entity receives the advertising or promotional materials. The future economic benefit that will flow to the entity will therefore change. In particular, the staff considers that, having now received the advertising and promotional materials, the entity should derecognise any prepayment. Having derecognised the prepayment, the entity should consider whether there is some other form of asset that it may recognise.

27. On 1 March, the only future economic benefit that will flow to the entity will be the future increase in sales resulting from the creation or enhancement of a customer relationship or brand by the advertising activity. The staff considers that the key question which needs to be considered in determining whether this

asset may be recognised is whether those future increased sales can be considered to be probable.

28. The staff believes that the Board has previously considered a similar question when it considered the accounting for internally generated brands, mastheads, publishing titles, and customer lists which are discussed in paragraph 63-64 of IAS 38. In these cases, the Board concluded that ‘expenditure on such items cannot be distinguished from the cost of developing the business as a whole’ and therefore such items may not be recognised as intangible assets. In the Basis for Conclusions on IAS 38, paragraphs BCZ45 – BCZ46 state:

> *BCZ45 IAS 38 specifically prohibits the recognition as intangible assets of brands, mastheads, publishing titles, customer lists and items similar in substance that are internally generated. IASC believed that internally generated intangible items of this kind would rarely, and perhaps never, meet the recognition criteria in IAS 38. However, to avoid any misunderstanding, IASC decided to set out this conclusion in the form of an explicit prohibition.*
>
> *BCZ46 IAS 38 also clarifies that expenditure on research, training, advertising and start-up activities will not result in the creation of an intangible asset that can be recognised in the financial statements. Whilst some view these requirements and guidance as being too restrictive and arbitrary, they are based on IASC's interpretation of the application of the recognition criteria in IAS 38. They also reflect the fact that it is sometimes difficult to determine whether there is an internally generated intangible asset distinguishable from internally generated goodwill.*

29. The staff considers that the performance of an advertising or promotional activity creates or enhances a brand or customer relationship intangible asset. This enhanced asset gives rise to increased sales. Under IAS 38, this internally generated brand or customer relationship should not be recognised as an asset.

30. The staff therefore considers that view (f) above, that the cost be recognised as an expense over the 6 months commencing 1 April, is not an appropriate accounting treatment because the asset that exists over that period is the

enhanced customer relationship or brand which IAS 38 specifically states does not qualify for recognition.

31. The staff therefore believes that the only points at which the cost of developing content could be recognised as an expense are:

(c) 1 March – when the advertising materials are received

(d) 1 April – when the advertising materials are first used

(e) a third each on 1 April, 1 May, and 1 June when the adverts are aired

32. The staff notes that on 1 March the advertising and promotional material is delivered to the entity. The material has no value to any other entity separate from the entity's business as the advertising will be specific to that entity's products and brand. The only future economic benefits that will flow to the entity as a result of the advertising and promotional materials will be increased sales arising from the creation or enhancement of a brand or customer relationship.

33. IAS 38 prohibits the recognition of an intangible asset in respect of the brand or customer relationship on the basis that the increased sales are not sufficiently probable and cannot be separately identified. It may be argued that it would be inconsistent to justify the recognition of an asset for advertising and promotional materials on the basis of those same future increased sales.

34. It could therefore be argued that it is not appropriate for the entity to recognise any asset beyond receipt of the advertising and promotional material on 1 March.

35. On the other hand it could be argued that, after receipt of the advertisement, the entity has the ability to use those materials to air the advertisement. Supporters of this view note that the advertising and promotional materials represent an asset because they avoid the need for the entity to incur additional costs in the future to develop advertising or promotional materials. They contend that, up to 1 April, the entity has an asset represented by its ability to avoid future cash outflows. It is therefore appropriate to recognise an asset at least until 1 April.

36. This ability to avoid future cash outflows will be present through the period in which the advertising is expected to take place. Some may therefore argue that

it is appropriate to recognise the cost of the advertising proportionally over the course of the advertisements.

37. The staff notes that one potential difficulty with this approach is that an entity may be able to use advertising or promotional material over an extended period. For example, an entity may have an advertising campaign which has a very intense period of initial advertising with reminders aired at 6 monthly intervals after the initial campaign. Questions may arise as to the period over which it is appropriate to recognise the advertising expense in such a situation.

Staff view

38. The staff considers that, avoiding future advertising spend should not qualify an item of advertising or promotional material as an asset.

39. The staff therefore believes that, in order to justify carrying advertising and promotional materials as an asset, it is necessary to demonstrate that those materials will generate some future economic benefits for the entity other than merely avoiding future spend on advertising and promotional activities. The staff believes that the only future economic benefits that will flow to the entity as a result of advertising and promotional spend are future increased sales arising from new or enhanced brands or customer relationships.

40. The staff also notes that these future increased sales are exactly the same increased sales that the Board concluded did not justify the recognition of internally generated ‘customer relationships’ or ‘brands’. It would be inconsistent to not allow an entity to recognise as an asset customer relationships or brands because the future economic benefits could not be separately identified, and yet to allow the entity to recognise an asset in respect of materials that can only be used to create or enhance those relationships or brands.

41. Since IAS 38 has already concluded that it is not possible to separately identify cashflows that will be generated by a brand, masthead, customer list or similar asset, the staff considers that it would be inappropriate for an entity to recognise as an asset advertising and promotional materials that will be used to generate such an asset and can only be used for that purpose.

42. In effect, the staff sees the advertising materials as being work-in-progress for the production of an intangible asset which cannot be recognised. As such, the staff believes that such costs should be recognised as an expense immediately that the advertising materials are received by or made available to the entity (which would be on 1 March in the illustrative example included in attachment 1.)

Does the Board agree with the staff's recommendation that such expenditure be recognised as an expense when the materials are received by the entity?

Extending the analysis to catalogues

43. Having considered the example of a TV slot, the staff went on to consider the example of a catalogue.

44. In this situation, the advertising content comprises the pictures, text and typefaces used in the catalogue. The communication medium could be seen as the paper, printing, and postage used to communicate the content to the customer.

45. Applying the same methodology as is proposed above for TV slots would result in:

- The recognition of an expense in respect of the photographs, text, typesetting etc at the time at which they were delivered or made available to the entity.
- The recognition of an expense in respect of the paper used to print the catalogues when the paper is used in the printing process.

46. The staff considers that, whilst the point at which the paper etc is used by the entity may be arbitrary in the sense that an entity may advance or delay printing, it represents the point at which the entity ceases to have access to certain potential future economic benefits.

47. For example, if an entity acquires 10,000 reams of paper to print its catalogues, then it has access to two different potential economic benefits. Firstly, it has the benefit which may be derived from having the paper to print on. Secondly, it has the potential economic benefit in that it could sell the paper if necessary or use it for other purposes. Once the paper has been printed, the entity will no

longer have the ability to sell the paper or to use it for another purpose. As such, its only potential economic benefit will be access to the future flows associated with increased sales arising from the enhanced brand or customer relationship developed by the advertising.

Does the Board agree that the staff's recommendation in respect of TV slots can be extended to catalogues and other forms of advertising in this way?

Other Items

48. When the IFRIC recommended changing IAS 38 in respect of advertising and promotional spend, it also recommended that the same changes be made in respect of expenditure on training activities.

49. The IFRIC considered that training activities shared many of the key features of advertising and promotional activities. In particular, both types of activity involve expenditure which creates or enhances an asset which cannot be recognised (a trained workforce in the case of training and a brand or customer relationship in the case of advertising and promotion). The IFRIC therefore recommended that the changes which they proposed in respect of advertising and promotional activities should also apply to training activities.

50. The staff notes that, paragraph 69 of IAS 38 discusses not only advertising and promotional and training activities but also start-up activities and expenditure on relocating or reorganising part or all of an entity.

51. The staff considers that, in many circumstances, start-up activities will also be advertising and promotional activities. The staff would therefore be concerned if a model were developed which may result in the same costs being accounted for differently depending upon whether they were classified as advertising and promotional costs or start-up costs.

52. The staff therefore considers that a similar accounting model should be applied to training, advertising and promotional activities, and start-up activities.

53. Having reached that conclusion, the staff then considered what the common features were of such arrangements and whether there was a class of transaction to which they all belong which should attract the same accounting treatment.

54. The staff considered that the key feature of advertising and promotional, training, and start-up activities is that the purpose of each of those activities is to create or enhance an intangible asset which cannot be recognised under IAS 38.

55. The staff therefore considers that expenditure on activities, the purpose of which is to create or enhance an intangible asset which cannot be recognised under IAS 38, should be recognised as an expense when the entity can receive no alternative economic benefits for the expenditure other than using it to create or enhance the intangible asset.

Does the Board agree with this approach?

56. The staff notes that paragraph 70 of IAS 38 also considers expenditure on relocation or reorganisation. The staff has therefore considered at what point such expenditure should be recognised as an expense.

57. The staff notes that requiring such costs to be recognised as an expense at the point at which the entity can receive no alternative economic benefits for the spend (other than carrying out the reorganisation or relocation) would be consistent with the time at which such expenditure would be recognised as an expense in accordance with the Board's proposed amendments to IAS37.

58. The staff therefore believes that, if this proposed treatment of advertising and promotional activities were extended to all of the items in IAS 38.69, it would result in a consistent treatment with other standards.

Prepayments

59. The staff notes the current wording in IAS 38.70 relating to prepayments which 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.

60. From discussions with the IFRIC, the staff is aware that some entities use this definition of a prepayment to justify carrying advertising and promotional materials on the balance sheet until those materials or services have been delivered or rendered <u>to the entity's customers</u>.

61. The staff considers that, regardless of whether another kind of asset is recognised subsequent to the receipt of goods or services by an entity, an entity should only recognise a prepayment between the time that it pays for goods or services and the time that that entity receives those goods and services.

62. Once an entity has received the related goods or services, the cost of the prepaid service should be recognised as an expense unless the goods or services received meet the criteria for recognition as another asset in accordance with a relevant IFRS (for example IAS 38 *Intangible Assets* or IAS 16 *Property, Plant, and Equipment*).

63. The staff recommends that IAS 38.70 should be amended to reflect the fact that a prepayment may only be recognised by an entity until that entity receives the related goods or services.

64. In making this change, the staff does not wish to preclude entities from recognising assets after delivery. However, the staff does not believe that categorising an asset as a prepayment should provide a justification for maintaining an asset on the balance sheet until the asset is used to service future customers.

Does the Board agree with the staff's recommendation?

Use of the annual improvements process

65. From the previous discussions of this issue at IFRIC and Board meetings the staff is aware that differing practices currently exist for the treatment of costs of advertising and promotional activities.

66. In particular the staff is aware that in some jurisdictions an expense is recognised immediately that advertising and promotional materials are received by an entity. In others, an expense is recognised on the date on which the advertisement takes place.

67. The staff therefore considers that, whatever the Board's conclusions as to when these costs should be recognised, changes to IAS 38 are likely to create a change in practice in some jurisdictions.

68. A question has therefore been raised as to whether the annual improvements process is an appropriate mechanism to make these changes.

69. The staff considers that the diversity in practice illustrates that the present wording of IAS 38 is not clear. The staff therefore believes that a change to the wording would be beneficial.

70. Furthermore the staff considers that, whilst amending the standard would result in some changes in practice, this would be due to clarifying the existing standard rather than introducing new requirements.

71. Additionally, whilst for some entities the change in treatment may have a significant impact, the staff considers that for most entities, the time between the receipt and use of advertising and promotional materials is likely to be relatively short. Furthermore, for entities which run regular periodic advertising campaigns, any effect on profit is likely to be reduced, with the main impact being a balance sheet effect. The effects of the change are therefore likely to be insignificant for most entities.

72. The staff therefore recommends that the changes to reflect the above accounting treatment be made as part of the annual improvements process

Does the Board agree with this recommendation?

Attachment 1 – Illustrative example timeline for advertising and promotional activities