Section 12,130

Practice Bulletin 13
Direct-Response Advertising and Probable Future Benefits

December, 1994

NOTICE TO READERS

Practice Bulletins are issued to disseminate the views of the Accounting Standards Executive Committee on narrow financial accounting and reporting issues. The issues dealt with are those that have not been and are not being considered by the Financial Accounting Standards Board or the Governmental Accounting Standards Board. Practice Bulletins present the views on such issues of at least two-thirds of the members of the Accounting Standards Executive Committee, the senior technical body of the AICPA authorized to speak for the AICPA on financial accounting and reporting.

Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, identifies AICPA Practice Bulletins as a source of established accounting principles generally accepted in the United States that an AICPA member should consider if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. If relevant to the circumstances of the transaction or event, the accounting treatment specified by this Practice Bulletin should be used, or the member should be prepared to justify the departure.

Introduction

.01 In December 1993, the AICPA's Accounting Standards Executive Committee (AcSEC) issued Statement of Position (SOP) 93-7, *Reporting on Advertising Costs* [section 10,590]. SOP 93-7 [section 10,590] provides guidance on financial reporting on advertising costs and requires that an entity report the costs of all advertising as expenses either in the periods in which those costs are incurred, or the first time the advertising takes place, except for certain direct-response advertising. The costs of direct-response advertising that result in probable future benefits should be capitalized and amortized over the estimated period of the future benefits.

Direct-Response Advertising

.02 Paragraph 33 of SOP 93-7 [section 10,590.33] states that the costs of direct-response advertising should be capitalized if both of the following conditions are met:

a. The primary purpose of the advertising is to elicit sales to customers who could be shown to have responded specifically to the advertising. (Paragraph 34 of SOP 93-7 [section 10,590.34] discusses the conditions that must exist in order to conclude that the advertising's purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising.)

b. The direct-response advertising results in probable future benefits. (Paragraph 37 of SOP 93-7 [section 10,590.37] discusses the conditions that must exist in order to conclude that direct-response advertising results in probable future benefits.)

.03 Paragraph 36 of SOP 93-7 [section 10,590.36] states that "probable future benefits of direct-response advertising activities are probable future revenues arising from that advertising in excess of future costs to be incurred in realizing those revenues." Practice has interpreted *probable future revenues* in different ways. Some believe that future revenues should be limited to revenue received from sales to customers receiving and responding to the direct-response advertisement. Others believe that future revenues should include revenue indirectly related to the advertisement. SOP 93-7 [section 10,590] does not explicitly address this issue.

.04 This practice bulletin interprets paragraphs 33, 36, and 46 through 48 of SOP 93-7 [section 10,590.33, .36, .46–.48] by clarifying that only revenue from sales to customers receiving and responding to the direct-response advertisement should be considered when determining probable future revenues.

Probable Future Revenues

.05 Revenues associated with direct-response advertising are as follows:

a. *Primary:* Revenues from sales to customers receiving and responding to the direct-response advertising

b. *Secondary:* Revenues other than revenues from sales to customers receiving and responding to the direct-response advertising

For example, most publishers receive revenue from customers that subscribe to the publications; these subscription revenues are primary revenues. Publishers also receive secondary revenues such as advertisements in the publications (referred to as *placement fees*). Placement fee revenues are affected by several factors, including the total number of subscribers to the publication and the selling efforts devoted to obtaining the placement fees.

Conclusion

.06 When determining *probable future revenues*, those revenues should be limited to revenues from sales to customers receiving and responding to the direct-response advertising (primary revenues).

.07 When evaluating whether the direct-response advertising results in probable future benefits (paragraph 33*b* of SOP 93-7 [section 10,590.33*b*]), probable future benefits should include only primary revenues. When amortizing and assessing the realizability of the direct-response advertising reported as assets, future revenues should be limited to primary revenues (paragraphs 46 through 48 of SOP 93-7 [section 10,590.46–.48]).

Effective Date and Transition

.08 This practice bulletin is effective for advertising costs incurred after December 31, 1994, or upon the adoption of SOP 93-7 [section 10,590], if later.

.09 Entities that adopt SOP 93-7 [section 10,590] on or prior to December 31, 1994, and that report the costs of direct-response advertising as assets based on the inclusion of secondary revenues in determining probable future revenues, may report advertising costs incurred on or prior to December 31, 1994, using one of the following alternatives:

a. Continue to include secondary revenues in determining probable future revenues for purposes of amortizing and assessing the realizability of direct-response advertising reported as assets at December 31, 1994.

b. For entities that have issued annual financial statements reflecting the adoption of SOP 93-7 [section 10,590], use only primary revenues for purposes of reporting the costs of direct-response advertising reported as assets and report the change in accounting as the cumulative effect of a change in accounting principle as prescribed by paragraph 20 of Accounting Principles Board Opinion No. 20, *Accounting Changes*.

c. For entities that have not issued annual financial statements, use only primary revenues for purposes of reporting the costs of direct-response advertising as assets.

Discussion of Conclusion

Probable Future Revenues

.10 SOP 93-7 [section 10,590] establishes narrow conditions for reporting the costs of advertising as an asset beyond the first time the advertising takes place. Those conditions are based, in part, on future benefits resulting from the advertising. Some entities have interpreted SOP 93-7 [section 10,590] to allow the inclusion of secondary sources of revenue when determining probable future benefits. That practice extends, beyond AcSEC's intent, the link between the customers responding to the direct-response advertising and the probable future revenues resulting from the advertising. This practice bulletin clarifies that AcSEC intended that only primary revenues should be included in the determination of probable future revenues.

Transition

.11 SOP 93-7 [section 10,590] was issued in December 1993 and is effective for financial statements for years beginning after June 15, 1994, with earlier application encouraged in fiscal years for which financial statements previously have not been issued. SOP 93-7 [section 10,590] did not explicitly address the issue of whether secondary revenues should be included in probable future benefits. Therefore, some entities that early adopted SOP 93-7 [section 10,590] included secondary revenues in determining probable future revenues, and as a result reported direct-response advertising costs as assets that would not be reported as assets under this practice bulletin.

.12 AcSEC acknowledges that transition, to a significant extent, is a practical matter. A major objective of transition is to mitigate disruption to the extent possible without unduly compromising the objectives of the accounting guidance in this practice bulletin and consistency among reporting entities.

AcSEC believes that those entities that adopted SOP 93-7 [section 10,590] prior to its effective date did so in good faith and should not be required to restate annual financial statements previously issued. AcSEC further believes that few entities both adopted SOP 93-7 [section 10,590] prior to its effective date and included secondary revenues when determining probable future revenues. Therefore, consistency among reporting entities has not been compromised significantly.

Accounting Standards Executive Committee (1993-1994)

AICPA Staff

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