Section 10,590

Statement of Position 93-7
Reporting on Advertising Costs

December 29, 1993

NOTE

Statements of Position (SOPs) of the Accounting Standards Division present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, identifies AICPA SOPs as sources of established accounting principles 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. In such circumstances, the accounting treatment specified by this SOP should be used or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

SOP 93-7 is amended by SOP 00-2, *Accounting by Producers or Distributors of Films*. SOP 00-2 is effective for financial statements for fiscal years beginning after December 15, 2000. Earlier application is encouraged. The cumulative effect of changes in accounting principles caused by adapting the provisions of this SOP should be included in the determination of net income in conformity with paragraph 20 of APB Opinion 20. Disclosure of pro forma effects of retroactive application (APB Opinion 20, paragraph 21) is not required. An entity should not restate previously issued annual financial statements.

Introduction

.01 The Accounting Standards Executive Committee (AcSEC) has on its agenda a project on reporting the costs of activities—such as advertising, preopening, start-up, training, customer acquisition, and similar activities—that are undertaken to create future economic benefits through the development of intangible assets. The project was undertaken to provide guidance that would aid in resolving issues concerning financial reporting for the costs of such activities.

.02 Because of the difficulty of developing sound financial reporting guidance that could be applied broadly to the costs of all activities, AcSEC decided that this statement of position (SOP) should be issued as a first step and be used to develop guidance for reporting costs of other kinds of activities undertaken to create such benefits although AcSEC has not begun deliberations to develop such guidance. The guidance in this SOP therefore is not intended to be used to account for the costs of other kinds of activities undertaken to create future economic benefits through the development of intangible assets.

.03 Some entities report the costs of all advertising as expenses when the costs are incurred. However, other entities report the costs of future economic benefits that they expect will result from some or all advertising as assets when the costs are incurred and amortize the costs to expense in the current and subsequent periods.

.04 The authoritative financial reporting literature provides no broad guidance on reporting the costs of advertising, although it does provide guidance for certain specific transactions and industries and on reporting the costs of activities similar to advertising. The lack of broad guidance and the inconsistency of existing guidance has led to diversity in practice.

.05 This SOP provides guidance for annual financial statements on the following:

- Reporting the costs of advertising, which should be expensed either as incurred or the first time the advertising takes place, except for direct-response advertising (*a*) whose primary purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising and (*b*) that results in probable future economic benefits
- For direct-response advertising that may result in reported assets—
  - — How such assets should be measured initially
  - — How the amounts ascribed to such assets should be amortized
  - — How the realizability of such assets should be assessed
- The financial statement disclosures that should be made about advertising
- Amendments to other accounting literature affected by this SOP
- Transition rules for applying this SOP

Scope

.06 This SOP provides financial reporting guidance for the annual financial statements of all entities and all advertising other than that for which pronouncements included in category (a) in paragraph 10 of Statement on Auditing Standards (SAS) No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, provide such guidance.[1] This SOP does not apply to financial statements for interim periods. Paragraphs 15 and 16 of Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*, which are discussed in the appendix of this SOP [paragraph .81], provide guidance for accounting for advertising in interim periods. This SOP amends the following AICPA SOPs[2]:

a. SOP 88-1, *Accounting for Developmental and Preoperating Costs, Purchases and Exchanges of Take-off and Landing Slots, and Airframe Modifications*, paragraph 22 [section 10,430.22]

b. SOP 89-5, *Financial Accounting and Reporting by Providers of Prepaid Health Care Services*, paragraph 54

c. SOP 90-8, *Financial Accounting and Reporting by Continuing Care Retirement Communities*, paragraph 15

.07 This SOP does not amend FASB Technical Bulletin 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*.

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[1] Category (a) in paragraph 10 of SAS No. 69 consists of Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins. Advertising that is covered by pronouncements in category (a) of paragraph 10 of SAS No. 69 should be accounted for in conformity with that guidance regardless of the guidance in this SOP.

[2] The appendix [paragraph .81] discusses the guidance concerning advertising in these SOPs. Paragraphs .51 to .53 of this SOP discuss the amendments to these SOPs.

.08 This SOP applies to not-for-profit organizations.

.09 Reporting on the costs of advertising conducted for others under contractual arrangements is part of reporting on contracts in general and is not covered by this SOP. Indirect costs that are specifically reimbursable under the terms of a contract also are excluded from this SOP.

Background

.10 FASB Statement No. 2, *Accounting for Research and Development Costs*, issued in 1974, requires all research and development costs to be reported as expenses when incurred. Therefore, FASB Statement No. 2 in effect prohibits reporting the research and development costs incurred in anticipation of probable future benefits as assets. Although activities similar to research and development were included in the discussion memorandum that initiated the FASB's project, paragraph 22 of appendix A of Statement No. 2 states that the FASB concluded, following the public hearing on the Discussion Memorandum, that the "initial Statement of Financial Accounting Standards resulting from the project should address solely accounting for research and development costs."

.11 Since issuing the discussion memorandum, the FASB has developed its conceptual framework, which provides conceptual criteria for asset recognition, and there has been periodic interest in how the costs of activities similar to research and development are reported on. The Securities and Exchange Commission (SEC) has issued some accounting and auditing enforcement releases on activities similar to research and development, and the SEC staff has expressed concern about the accounting for these activities.

.12 Costs incurred in anticipation of the probable future economic benefits of advertising generally have been expensed for the following reasons:

- Financial statement preparers generally presumed that the benefit period is short.
- The periods during which the future economic benefits probably would be received and the amounts of such benefits could not be measured and determined easily and objectively.
- The advertising costs for some entities were not material.

.13 Advertising is undertaken to provide or increase future economic benefits. FASB Statement on Financial Accounting Concepts (Concepts Statement) No. 6, *Elements of Financial Statements*, paragraph 178, states, "An entity commonly incurs costs to obtain future economic benefits, either to acquire assets from other entities in exchange transactions or to add value through operations to assets it already has . . . ." New technology, sources of information, and measurement techniques have given some entities the ability to better estimate the future economic benefits that could result from certain kinds of advertising.

.14 If future economic benefits do result from advertising, they generally would be in the form of revenue.

Authoritative Pronouncements

.15 FASB Concepts Statement No. 6, paragraph 25, defines assets as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events."[3] Footnote 18 to Concepts Statement No. 6 states that "*probable* is used with its usual general meaning, rather than in a specific accounting or technical sense, . . . and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved . . . ." Paragraph 26 states:

> An asset has three essential characteristics: (*a*) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (*b*) a particular entity can obtain the benefit and control others' access to it, and (*c*) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

.16 Appendix B of Concepts Statement No. 6 discusses in paragraphs 175 and 176 the characteristics of assets and the concept of probable future economic benefits, including those that may arise from activities such as advertising:

> Uncertainty about business and economic outcomes often clouds whether . . . particular items that might be assets have the capacity to provide future economic benefits to the entity, . . . sometimes precluding their recognition as assets. The kinds of items that may be recognized as expenses or losses rather than as assets because of uncertainty are some in which management's intent in taking certain steps or initiating certain transactions is clearly to acquire or enhance future economic benefits available to the entity. For example, business enterprises . . . advertise, develop markets . . . and spend significant funds to do so. The uncertainty is not about the intent to increase future economic benefits but about whether and, if so, to what extent they succeeded in doing so. Certain expenditures for . . . advertising . . . are examples of the kinds of items for which assessments of future economic benefits may be especially uncertain . . . .
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> If . . . advertising results in an entity's acquiring or increasing future economic benefit, that future economic benefit qualifies as an asset as much as do the future benefits from prepaid insurance or prepaid rent. The practical problem is whether future economic benefit is actually present and, if so, how much—an assessment that is greatly complicated by the feature that the benefits may be realized far in the future, if at all.

.17 Paragraphs 247 to 250 discuss deferred costs and acknowledge that advertising may provide future economic benefits, but they note that such benefits may not be reported as assets for practical reasons stemming from considerations of uncertainty or measurement. Paragraph 248 states, in part:

> The question that needs to be answered to apply the definition of assets is whether the economic benefit received by incurring those costs was used up at the time the costs were incurred or shortly thereafter or future economic benefit remains at the time the definition is applied. Costs such as . . . advertising services do not *by themselves* qualify as assets under the definition in paragraph 25 any more than do spoiled units, dry holes, or legal costs. The reason for considering the possibility that they might be accounted for as if they were assets stems from their possible relationship to future economic benefits.

.18 FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* paragraph 63, sets forth the following criteria that should be met to report an item in the financial statements:

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[3] Because assets should be understood to represent current conditions, the term *probable future economic benefits* in this SOP means that current prospects indicate that the reporting entity probably will receive economic benefits in the future.

Definitions—The item meets the definition of an element of financial statements.

Measurability—It has a relevant attribute measurable with sufficient reliability.

Relevance—The information about it is capable of making a difference in user decisions.

Reliability—The information is representationally faithful, verifiable, and neutral.

.19 No authoritative pronouncement provides broad guidance on financial reporting on advertising. However, aspects of the following documents, discussed in the appendix [paragraph .81], provide guidance on reporting on advertising in connection with specific items or industries.

a. FASB Statement No. 13, *Accounting for Leases*, as amended by FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

b. FASB Statement No. 51, *Financial Reporting By Cable Television Companies*

c. FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*[*]

d. FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*

e. FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

f. The AICPA Industry Audit Guide *Audits of Airlines*, as amended by SOP 88-1, *Accounting for Developmental and Preoperating Costs, Purchases and Exchanges of Take-off and Landing Slots, and Airframe Modifications* [section 10,430]

g. The AICPA Industry Audit Guide *Audits of Stock Life Insurance Companies*

h. SOP 89-5, *Financial Accounting and Reporting by Providers of Prepaid Health Care Services*

i. FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*

.20 Aspects of the following documents, also discussed in the appendix [paragraph .81], provide further guidance on reporting on activities similar to research and development:

a. APB Opinion 17, *Intangible Assets*[**]

b. APB Opinion 28, *Interim Financial Reporting*

c. FASB Statement No. 2, *Accounting for Research and Development Costs*

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[*] In 2000, the FASB rescinded FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*, and AcSEC issued SOP 00-2, *Accounting by Producers or Distributors of Films* [section 10,800]. The provisions of this SOP apply to entities within the scope of SOP 00-2 [section 10,800]. [Footnote added, June 2004, to reflect conforming changes necessary due to the rescission of FASB Statement No. 53 and the issuance of SOP 00-2.]

[**] FASB Statement No. 142, *Goodwill and Other Intangible Assets,* supersedes APB Opinion No. 17, *Intangible Assets*. [Footnote added, June 2004, to reflect conforming changes necessary due to the issuance of FASB Statement No. 142.]

d. FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*

e. FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*

f. FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*

g. The AICPA Audit and Accounting Guide *Audits of Property and Liability Insurance Companies*

h. SOP 90-8, *Financial Accounting and Reporting by Continuing Care Retirement Communities*

.21 The guidance in the pronouncements listed in the two preceding paragraphs is not consistent. Some believe that pronouncements permitting capitalization of advertising do so because a clearly demonstrable cause-and-effect relationship exists between the assets acquired and costs incurred. Also, some believe that pronouncements prohibiting capitalization of advertising do so because (*a*) no such demonstrable causal relationship exists, (*b*) the amounts capitalized would be immaterial, or (*c*) the costs of obtaining the information would not be justified by the benefits of reporting it. The conclusions reached in this SOP are based on the guidance in the FASB Concepts Statements.

Description of Advertising

.22 Advertising is the promotion of an industry, an entity, a brand, a product name, or specific products or services so as to create or stimulate a positive entity image or to create or stimulate a desire to buy the entity's products or services.[4]

.23 Advertising is one kind of customer acquisition activity. Financial reporting of other kinds of customer acquisition activities is outside the scope of this SOP.[5]

.24 Advertising generally uses a form of media—such as mail, television, radio, telephone, facsimile machine, newspaper, magazine, coupon, or billboard—to communicate with potential customers. Examples of kinds of advertising include the following:

- Directory and buyer's guide advertising
- Business and industrial publications
- Reprints of advertisements
- Television advertising
- Direct-mail advertising
- Consumer publications
- Radio advertisements
- Billboard advertisements
- Company and product catalogues
- Cooperative advertising

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[4] Fund-raising by not-for-profit organizations is not considered advertising and is not within the scope of this SOP. However, this SOP does apply to advertising activities of not-for-profit organizations.

[5] The costs of premiums, contest prizes, gifts, and similar promotions, as well as discounts or rebates, including those resulting from the redemption of coupons, are not considered advertising costs for purposes of applying the guidance in this SOP. (Other costs of coupons and similar items, such as costs of newspaper advertising space, are considered advertising costs.)

- Booklets for sales promotion
- Newspaper advertising
- Point-of-sale material
- Sponsorship of public events

Conclusions

.25 The following conclusions should be read in conjunction with "Discussion of Conclusions and Implementation Guidance," beginning with paragraph .55 of this SOP, which explains the basis for the conclusions and provides guidance for implementing them.

Expensing or Capitalizing Advertising Costs

.26 The costs of advertising should be expensed either as incurred or the first time the advertising takes place (paragraphs .42 to .44 elaborate on component costs of advertising),[6] except for—

a. Direct-response advertising (1) whose primary purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising and (2) that results in probable future economic benefits (future benefits). (Paragraph .37 discusses the conditions that must be met in order to conclude that direct-response advertising results in probable future benefits.) Examples of the first time advertising takes place include the first public showing of a television commercial for its intended purpose and the first appearance of a magazine advertisement for its intended purpose.

b. Expenditures for advertising costs that are made subsequent to recognizing revenues related to those costs, as discussed in paragraph .27.

.27 Expenditures for some advertising costs are made subsequent to recognizing revenues related to those costs. For example, some entities assume an obligation to reimburse their customers for some or all of the customers' advertising costs (cooperative advertising). Generally, revenues related to the transactions creating those obligations are earned and recognized before the expenditures are made. For purposes of applying this SOP, those obligations should be accrued and the advertising costs expensed when the related revenues are recognized.

.28 The costs of direct-response advertising (*a*) whose primary purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising and (*b*) that results in probable future benefits should be reported as assets net of accumulated amortization. For purposes of calculating amortization and assessing realizability, which are discussed in paragraphs .46 to .48, each significant advertising effort establishes a separate stand-alone cost pool.

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[6] Deferring the costs of advertising until the advertising takes place assumes that the costs have been incurred for advertising that will occur. Such costs should be expensed immediately if such advertising is not expected to occur.

.29 The accounting policy selected from the two alternatives in the beginning of paragraph .26 (whether advertising costs are expensed as incurred or the first time the advertising takes place), should be applied consistently to similar kinds of advertising activities.

Tangible Assets

.30 Tangible assets, such as blimps or billboards, may be used for several advertising campaigns. The costs of such assets should be capitalized and depreciated or amortized using a systematic and rational method over their expected useful lives. That depreciation or amortization may be a cost of advertising if the tangible asset is used for advertising.

.31 For purposes of applying this SOP, costs incurred to produce film or audio and video tape to be used to communicate advertising do not create tangible assets.

.32 Sales materials, such as brochures and catalogues, may be accounted for as prepaid supplies until they no longer are owned or expected to be used, in which case their cost would be a cost of advertising and should be accounted for in conformity with the guidance in this SOP.

Direct-Response Advertising

.33 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 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 discusses the conditions that must exist in order to conclude that direct-response advertising results in probable future benefits.)

.34 In order to conclude that advertising elicits sales to customers who could be shown to have responded specifically to the advertising, there must be a means of documenting that response, including a record that can identify the name of the customer and the advertising that elicited the direct response. Examples of such documentation include the following:

- Files indicating the customer names and the related direct-response advertisement
- A coded order form, coupon, or response card, included with an advertisement, indicating the customer name
- A log of customers who have made phone calls to a number appearing in an advertisement, linking those calls to the advertisement

.35 Direct-response advertising activities exclude advertising that, though related to the direct-response advertising, is directed to an audience that could not be shown to have responded specifically to the direct-response advertising. For example, a television commercial announcing that order forms (that are direct-response advertising) soon will be distributed directly to some people in the viewing area would not be a direct-response advertising activity because the television commercial is directed to a broad audience, not all of which could be shown to have responded specifically to the direct-response advertising.

Probable Future Benefits of Direct-Response Advertising

.36 The 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.

.37 Demonstrating that direct-response advertising will result in future benefits requires persuasive evidence that its effects will be similar to the effects of responses to past direct-response advertising activities of the entity that resulted in future benefits. Such evidence should include verifiable historical patterns of results for the entity. Attributes to consider in determining whether the responses will be similar include (*a*) the demographics of the audience, (*b*) the method of advertising, (*c*) the product, and (*d*) economic conditions.

.38 Industry statistics would not be considered objective evidence that direct-response advertising will result in future benefits in the absence of the specific entity's operating history. If the entity does not have an operating history for a particular product or service but does have operating histories for other new products or services, statistics for the other products or services may be used if it can be demonstrated that the statistics for the other products or services are likely to be highly correlated to the statistics of the particular product or service being evaluated. For example, test market results for a new product or service may be used to support the view that the results of advertising for current new products or services are likely to be highly correlated with the results of advertising for new products or services previously sold by the entity. In the absence of the expectation of a high degree of correlation, a success rate based on historical ratios of successful products or services to total products or services introduced to the marketplace would not be a sufficient basis for reporting a portion of the costs of current-period advertising as resulting in assets.

.39 Direct-response advertising costs that are not capitalized because it cannot be demonstrated that the direct-response advertising will result in future benefits should not be retroactively capitalized in subsequent periods if historical evidence in those subsequent periods indicates that the advertising did in fact result in future benefits.

Basis of Measurement

.40 Based on the potential customers and the probable customer response rates, direct-response advertising that is expected to produce future revenues generally is undertaken before the customers' identity is known. Such advertising is undertaken with the expectation that not all targets of the direct-response advertising will provide benefits but that the benefits created by the customers who do respond to the advertising will justify the total advertising costs. Accordingly, the cost of the direct-response advertising directed to all prospective customers, not only the cost related to the portion of the potential customers that are expected to respond to the advertising, should be used to measure the amounts of such reported assets.

Costs of Direct-Response Advertising

.41 Costs of direct-response advertising that should be included in amounts reported as assets include only the following:

a. *Incremental direct costs of direct-response advertising incurred in transactions with independent third parties*—Examples of those costs may include, but are not limited to, costs of idea development, writing advertising copy, artwork, printing, magazine space, and mailing.

b. *Payroll and payroll-related costs for the direct-response advertising activities of employees who are directly associated with and devote time to the advertising reported as assets*—Examples of those activities may include, but are not limited to, idea development, writing advertising copy, artwork, printing, and mailing. The costs directly related to those advertising activities should include only that portion of employees' total compensation and payroll-related fringe benefits directly related to time spent performing such activities.

For purposes of this SOP, administrative costs, rent, depreciation other than depreciation of assets used directly for advertising activities (as discussed in paragraph .30), and other occupancy costs are not costs of direct-response advertising activities.

Components of Advertising Activities

.42 Advertising activities may have several component costs. Two primary components, which are made up of other components, are the costs of (*a*) producing advertisements, such as the costs of idea development, writing advertising copy, artwork, printing, audio and video crews, actors, and other costs, and (*b*) communicating advertisements that have been produced, such as the costs of magazine space, television airtime, billboard space, and distribution (postage stamps, for example).

Producing Advertising

.43 Costs of producing advertising are incurred during production rather than when the advertising takes place.

Communicating Advertising

.44 Costs of communicating advertising are not incurred until the item or service has been received and should not be reported as expenses before the item or service has been received, except as discussed in paragraph .27. For example—

- The costs of television airtime should not be reported as advertising expense before the airtime is used. Once it is used, the costs should be expensed, unless the airtime was used for direct-response advertising activities that meet the criteria for capitalization under this SOP.
- The costs of magazine, directory, or other print media advertising space should not be reported as advertising expense before the space is used. Once it is used, the costs should be expensed, unless the space was used for direct-response advertising activities that meet the criteria for capitalization under this SOP.

Executory Contracts

.45 Some activities, such as product endorsements and sponsorships of events, may be performed pursuant to executory contracts. Costs incurred under executory contracts generally are recognized as performance under the contract is received. Executory contracts should be evaluated to determine whether the costs recognized under such contracts are advertising costs. To the extent that those costs are advertising costs, such costs should be accounted for in conformity with the guidance in this SOP.

Amortization of Capitalized Advertising Costs

.46 The amounts at which direct-response advertising is reported as assets should be amortized on a cost-pool-by-cost-pool basis over the period during which the future benefits are expected to be received using the method described in paragraph .47.

.47 The amortization should be the amount computed using the ratio that current period revenues for the direct-response advertising cost pool bear to the total of current and estimated future period revenues for that direct-response-advertising cost pool. The amounts in this calculation should not be discounted to net present value. The estimated amounts of future revenues for that cost pool may increase or decrease over time, and the ratio should be recalculated at each reporting date.[7]

Assessment of Realizability and Subsequent Measurement

.48 The realizability of the amounts of direct-response advertising reported as assets should be evaluated at each balance-sheet date by comparing the carrying amounts of such assets on a cost-pool-by-cost-pool basis to the probable remaining future net revenues expected to result directly from such advertising. (For this evaluation, future net revenues are gross revenues less the probable future costs of all goods and activities necessary to earn those revenues, except amortization of direct-response advertising. Examples of such future costs are the costs of goods sold, sales commissions, and payroll and payroll-related costs associated with the future revenues.) If the carrying amounts of such advertising exceed the remaining future net revenues that probably will be realized from such advertising, the excess should be reported as advertising expense of the current period. The reduced carrying amounts should not be adjusted upward if estimates of future net revenues are subsequently increased.[8]

Disclosures

.49 The notes to the financial statements should disclose the following:

a. The accounting policy selected from the two alternatives in the beginning of paragraph .26 for reporting advertising, indicating whether such costs are expensed as incurred or the first time the advertising takes place

b. A description of the direct-response advertising reported as assets (if any), the accounting policy for it, and the amortization period

c. The total amount charged to advertising expense for each income statement presented, with separate disclosure of amounts, if any, representing a write-down to net realizable value

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[7] Changes in estimated future revenues for a direct-response-advertising cost pool should be reflected in the amortization calculation for current and future periods. Therefore, such changes in estimates would not result in reporting amounts expensed in prior periods as assets in the current or subsequent periods.

[8] [Footnote deleted.]

d. The total amount of advertising reported as assets in each balance sheet presented

.50 The following illustrates the disclosures discussed in paragraph .49:

Note X. Advertising

The Company expenses the production costs of advertising the first time the advertising takes place, except for direct-response advertising, which is capitalized and amortized over its expected period of future benefits.

Direct-response advertising consists primarily of magazine advertisements that include order coupons for the Company's products. The capitalized costs of the advertising are amortized over the three-month period following the publication of the magazine in which it appears.

At December 31, 19XX, $1,000,000 of advertising was reported as assets. Advertising expense was $10,000,000 in 19XX, including $500,000 for amounts written down to net realizable value.

Amendments to Other Guidance

.51 This SOP amends SOP 88-1 [section 10,430] by requiring advertising costs incurred in connection with route developmental costs related to the preparation of new route operations to be accounted for in conformity with the guidance in this SOP, rather than expensed as incurred. Paragraph 22 of SOP 88-1 [section 10,430.22] is amended as follows:

> Because of the current deregulated environment and the uncertainty regarding the recoverability of route developmental costs, the majority of the Accounting Standards Executive Committee (AcSEC) believes that developmental costs, other than advertising costs, related to preparation of operations of new routes should not be capitalized, as previously permitted under the guide. (Advertising costs should be accounted for in conformity with the guidance in SOP 93-7, *Reporting on Advertising Costs.*) Route expansion or alteration has become a recurring activity among the airlines, and any related cost is considered a normal and recurring cost of conducting business.

.52 This SOP amends SOP 89-5 by requiring advertising costs incurred as contract acquisition costs to be accounted for in conformity with the guidance in this SOP, rather than expensed as incurred. Paragraph 54 of SOP 89-5 is amended as follows:

> Although there is theoretical support for deferring certain acquisition costs, acquisition costs of providers of prepaid health care services, other than costs of advertising, should be expensed as incurred. (Advertising costs should be accounted for in conformity with the guidance in SOP 93-7, *Reporting on Advertising Costs*.)

.53 This SOP amends SOP 90-8 by clarifying that advertising costs incurred in connection with acquiring initial continuing care contracts should be accounted for in conformity with the guidance in this SOP. SOP 90-8 is amended by adding the following as a footnote after the word "advertising" in the second bullet in paragraph 15:

> Accounting for costs of advertising is not covered by this SOP. (Advertising costs should be accounted for in conformity with the guidance in SOP 93-7, *Reporting on Advertising Costs*.)

Effective Date and Transition

.54 This SOP is effective for financial statements for years beginning after June 15, 1994. Earlier application is encouraged in fiscal years for which financial statements previously have not been issued. Costs incurred, regardless of whether or not they are reported as assets, before the initial application of this SOP should not be adjusted to the amounts that would have been reported as assets had this SOP been in effect when those costs were incurred. However, the concepts included in the provisions of paragraphs .46 and .47 (amortization), paragraph .48 (assessment of realizability), and paragraph .49 (disclosures) of this SOP should be applied to any unamortized costs reported as assets before the initial application of this SOP that continue to be reported as assets after the effective date. In the year this SOP is first applied, the financial statements should disclose the nature of the accounting changes adopted to conform to the provisions of this SOP and their effect on income before extraordinary items, net income, and related per share amounts.

Discussion of Conclusions and Implementation Guidance

Expensing the Costs of Advertising Either as Incurred or the First Time the Advertising Takes Place, Unless the Advertising Is Direct-Response Advertising That Is Capitalized Under the SOP

.55 Practice for reporting the costs of advertising is diverse and includes the following:

- Some entities expense all such costs as the component services or items are performed or received. For example, the costs of hiring an actor to film a television commercial, which is one kind of component cost of television advertising, may be expensed when the actor has completed his or her acting assignment.
- Some entities expense such costs the first time the advertising takes place.
- Some entities expense such costs over the estimated life of the advertising.
- Some entities view the practices described in the three previous bulleted items as points on a continuum, and they expense those costs at some point on that continuum.
- Some entities expense such costs over the period that revenues are expected to result from the advertising.

.56 Some believe that all costs of advertising activities, other than direct-response advertising that results in probable future benefits and is capitalized in conformity with the guidance in paragraph .26, should be expensed as the component activities occur. They believe that if the costs of the component activities are not capitalized under the SOP because it cannot be demonstrated that there is an asset after the advertising occurs, it follows that there is no basis for concluding that there is an asset before the advertising occurs.

.57 FASB Concepts Statement No. 5, paragraph 86, states that—

> Consumption of economic benefits during a period may be recognized either directly or by relating it to revenues recognized during the period:
>
> . . . b. Many expenses, such as selling and administrative salaries, are recognized during the period in which cash is spent or liabilities are incurred for goods and services that are used up either simultaneously with acquisition or soon after. [*Footnote reference omitted.*]

Some believe that the component costs of advertising activities, other than direct-response advertising that results in probable future benefits and is capitalized in conformity with the guidance in paragraph .26, result in assets until at least the first time the advertising occurs. They believe that such costs are not capitalized under this SOP after the advertising occurs because they do not result in *demonstrable* probable future economic benefits, not because they do not result in any probable future economic benefits. However, they believe that the component costs of advertising have, at a minimum, benefits that are received simultaneously with the advertising. They note that there must be some economic benefit to advertising activities because entities continue to undertake them. They also note that there is no opportunity for an entity to benefit from advertising until it occurs. Therefore, they conclude that it is reasonable to defer such costs until the first time the advertising takes place.

.58 Some believe the component costs of advertising activities, other than direct-response advertising that results in probable future benefits and is capitalized in conformity with the guidance in paragraph .26, result in assets and should be amortized over the life of the advertising. They believe that the component costs of advertising have benefits that are received over the period the advertising is used. They note that there must be some economic benefit to advertising activities over the period they are used, because entities incur incremental costs to undertake them. Some believe that advertising should be expensed over the period in which revenues are expected to result from the advertising.

.59 AcSEC believes that the views discussed in paragraphs .55 through .58 have merit and acknowledges that choosing from among the accounting methods resulting from them is based to some extent on arbitrary judgments. AcSEC believes that the views discussed in paragraph .58 should not be adopted for advertising other than direct-response advertising, because probable future benefits beyond the first time the advertising takes place are too uncertain and are not demonstrable or measurable with the degree of reliability required to recognize an asset. Further, AcSEC believes the diversity in practice should be limited. AcSEC believes that the costs of advertising that otherwise would not be capitalized under the SOP should be expensed no later than the first time the advertising takes place. However, AcSEC is unable to reach a consensus on whether the costs of advertising that would otherwise not be capitalized under this SOP should be expensed (*a*) as incurred or (*b*) the first time the advertising takes place. Therefore, for practical reasons (including the likelihood that, for most entities, the financial statement effect of choosing the accounting described by (*a*) to the exclusion of (*b*), or vice versa, would be immaterial), AcSEC has concluded that entities should expense the costs of advertising that otherwise would not be capitalized under this SOP either as incurred or the first time the advertising takes place.

Capitalization of Direct-Response Advertising Costs Based on FASB Concepts Statements

.60 AcSEC based its conclusions for capitalizing direct-response advertising on FASB Concepts Statement Nos. 5 and 6. AcSEC also considered other authoritative financial reporting literature that could be relevant to financial reporting for advertising. Such other literature is excerpted in the appendix [paragraph .81].

.61 AcSEC believes that advertising that results in an entity's acquiring or increasing probable future economic benefits meets the definition of an asset. However, for most advertising, those benefits cannot be measured with the degree of reliability required to report an asset in the financial statements. AcSEC believes that direct-response advertising that meets certain criteria is the only advertising that may result in benefits that can be measured with the degree of reliability required to report an asset in the financial statements after the first time the advertising takes place.

Recognition Criteria

.62 FASB Concepts Statement No. 5, paragraph 63, sets forth the criteria of definition, measurability, relevance, and reliability that should be met to report an item in the financial statements.

Definition of an Asset

.63 Paragraph 25 of Concepts Statement No. 6 states that "assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." Advertising can create assets according to that definition, and the costs of such advertising may qualify to be capitalized.

.64 The probable future benefits are probable future revenues arising from direct-response advertising in excess of the future costs to be incurred in realizing those revenues. Those assets are deferrals, within the meaning of paragraph 141 of Concepts Statement No. 6, resulting from current cash payments or their equivalent. Recognition in income of the costs of such assets is deferred until the future economic benefits underlying the assets are partly or wholly realized or lost.

.65 Historical patterns of responses to the direct-response advertising or contracts that are enforced generally are evidence that the reporting entity obtains the benefits and can control others' access to them.

Measurability

.66 The probable future revenues that will result from direct-response advertising that meets the conditions for capitalization under this SOP can be measured with the degree of reliability necessary to report the costs to obtain them as an asset in financial statements. The list of attributes in paragraph 67 of Concepts Statement No. 5 includes historical cost, net realizable value, and present value of future cash flows.

Relevance

.67 FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, paragraphs 34 to 40, states that financial reporting should provide information that is useful in making rational economic decisions. That includes information helpful to users in assessing the amounts, timing, and uncertainties of prospective net cash inflows, information about the economic resources of an enterprise, and information about the effects of transactions and circumstances that change resources. Information about the future revenues that will result from direct-response advertising and the costs incurred are relevant because they provide such information.

Reliability

.68 Paragraph 75 of Concepts Statement No. 5 states that to be reliable, information must be "representationally faithful, verifiable, and neutral." Paragraph 77 amplifies that statement:

> Unavailability or unreliability of information may delay recognition of an item, but waiting for virtually complete reliability or minimum cost may make the

> information so untimely that it loses its relevance. At some intermediate point, uncertainty may be reduced at a justifiable cost to a level tolerable in view of the perceived relevance of the information. If other criteria are also met, that is the appropriate point for recognition. Thus, recognition may sometimes involve a trade-off between relevance and reliability.

.69 There is a broad spectrum of advertising activities and circumstances in which they are undertaken. AcSEC believes that many kinds of advertising activities may result in assets that meet the recognition criteria of definition, measurability, and relevance. However, AcSEC believes that only certain direct-response advertising can meet the recognition criteria of reliability after the first time the advertising takes place. AcSEC believes advertising other than direct-response advertising would not result in assets that are measurable with the degree of reliability required to report an asset in the financial statements after the first time the advertising takes place.

Specificity of Conditions That Must Be Met in Order to Report the Probable Future Benefits of Direct-Response Advertising as Assets

.70 The conditions in this SOP that must be met in order to report the costs of direct-response advertising as assets beyond the first time the advertising takes place require reliable information. Those conditions are narrow because it is generally difficult to determine the probable future benefits of advertising with the degree of reliability sufficient to report the results of the advertising as assets.

.71 AcSEC considered providing guidance that would require or prohibit capitalization based on the use of econometric models, scanner studies, or other forms of data gathering as evidence that advertising leads to a response resulting in future benefits. Such forms of data gathering generally are designed to isolate the effects of all factors affecting revenue, such as advertising, price, and season, to estimate the effects of advertising on sales. AcSEC concluded that the SOP should prohibit capitalization of advertising based on the use of such information as evidence, because the effects of factors other than advertising on the production of revenue probably would not be measurable with the degree of reliability required to rely on such models.

Period and Extent of Expected Future Benefits

.72 The response to advertising usually occurs shortly after the advertising takes place, but in mail-order catalogue advertising, for example, it can take place over a longer period.

.73 AcSEC considered providing guidance that would either permit or prohibit reporting the costs of direct-response advertising as assets based on the inclusion of future revenues from renewals or repeat sales. Reporting entities with an established operating history, such as certain entities in subscription businesses, may be able to measure such amounts with the required degree of reliability and, if so, should report assets based on renewal amounts. The reporting entity must exercise judgment about (*a*) the existence of the degree of reliability required to determine the probability of renewals and (*b*) whether those renewals result from the direct-response advertising being accounted for. In order to conclude that the renewals result from the direct-response advertising being accounted for, the renewals must not result from significant direct-response advertising that took place subsequent to the direct-response advertising being accounted for. (As discussed in paragraph .28, each significant advertising effort establishes a separate stand-alone cost pool.) Examples of situations in which that required degree of reliability may exist, without significant direct-response advertising subsequent to the direct-response advertising being accounted for, include the following:

- The sale of subscriptions may be offered only through direct-response advertising. The entity may have objective evidence that, historically, a quantifiable percentage of subscriptions is renewed at the end of each subscription period without a significant advertising effort. After the subscription is purchased, in what is deemed to be an insignificant advertising effort, renewal subscriptions are offered for sale by mailing a renewal card to those who have subscriptions that will lapse soon. The amount of direct-response advertising reported as assets and amortized in future periods ordinarily would be based on the expected total revenue to be realized over both the initial and the renewal subscription periods.
- A series of products, such as pieces in a chess set, may be offered for sale only through direct-response advertising. After the first piece is purchased, the remaining pieces are offered for sale by mailing a response card to those who purchased the first piece in what is deemed to be an insignificant advertising effort. The entity may have objective evidence that, historically, each customer who buys the first piece will buy a quantifiable percentage of the remaining pieces. If each of the pieces is bought separately, the amount of direct-response advertising reported as assets and amortized in future periods ordinarily would be based on total revenue from all sales, including estimated future sales.

If significant marketing efforts are required to generate subsequent revenues through renewal or repeat sales, those subsequent revenues would not qualify as revenues resulting from the direct-response advertising that resulted in the initial sale and initial stand-alone cost pool. For example, in the previous bulleted item, if a pamphlet describing the chess set, its monetary and aesthetic value, and the history of the game of chess is sent to those who purchased the first piece, the amount of direct-response advertising reported as assets and amortized in future periods would be based on sales of the first piece rather than on the total of all sales including estimated future sales. However, subsequent direct-response advertising may result in the capitalization of the costs of that subsequent advertising, with its costs accumulated in a stand-alone cost pool, if the conditions for capitalization in this SOP are met.

.74 AcSEC concluded that it should not arbitrarily limit the period over which the direct-response advertising should be amortized. However, AcSEC believes that the reliability of accounting estimates decreases as the length of the period for which such estimates are made increases. Therefore, the period over which the benefits of direct-response advertising are amortized often is no longer than the greater of one year or one operating cycle. However, under certain circumstances, such as those discussed in paragraph .72, an entity may be able to demonstrate that the duration of the probable future benefits is greater than the longer of one year or one operating cycle.

Assets Should Be Reported Based on the Costs of the Advertising Directed to All Prospective Customers

.75 Paragraph .40 of this SOP states, in part, that the ". . . cost of the direct-response advertising directed to all prospective customers, not only the cost related to the portion of the potential customers that is expected to respond to the advertising, should be used to measure the amounts of such reported assets." Some believe that guidance to be inconsistent with guidance in other pronouncements issued by the FASB (such as FASB Statement Nos. 19 and 91) that require costs to be capitalized based on the portion of the costs expected to result in successful efforts. Other FASB pronouncements, such as FASB Statement No. 53, permit capitalization of advertising based on the cost of advertising directed to all potential customers.

.76 AcSEC compared and contrasted the guidance in this SOP with the guidance in FASB Statement Nos. 19 and 91. AcSEC concluded that, in general, any comparison of the guidance in Statement Nos. 19 and 91 should consider the differences in the kinds of activities addressed by those Statements and this SOP. In the extractive industries, drilling an oil well in a location without proven reserves can be viewed as a discrete effort; in financial industries, making or acquiring a loan can be viewed as a discrete effort. However, few would view an individual unit of advertising, such as one piece of advertising mailed as part of a direct-response advertising campaign, as a discrete effort. The entire mailing, not merely an individual piece of mail, constitutes the effort, and the advertiser evaluates the success of the advertising based on the response to the entire advertising effort, not on the response to one component of that effort.

.77 AcSEC believes the arguments supporting successful-effort accounting for exploration activities in the oil and gas industry are based on the inability to demonstrate, on an individual company basis, a direct cause-and-effect relationship between unsuccessful acquisition and exploration costs and revenues derived from successful activities in unrelated geological areas. For the kinds of activities capitalized under the guidance in this SOP, there is a reliable and demonstrated relationship between total costs and future benefits that is a direct result of incurring those costs. For example, reporting entities capitalizing advertising in conformity with this SOP would have reliable evidence that they must, for example, send out 1 million pieces of direct-mail advertising in order to get 10 thousand responses. The cost of obtaining those 10 thousand responses is the cost of sending out the million pieces of mail. The effort is the million pieces mailed, and documented operating history enables those reporting entities to make reliable predictions about the relationship between the total number of pieces of advertising mailed and the total future revenues obtained.

Acquisition Cost of the Assets

.78 AcSEC used FASB Statement Nos. 19 and 91 as a basis for determining the kinds of costs of direct-response advertising that result in assets that should be included in the acquisition cost of the assets. AcSEC believes that some activities, such as allocated overhead, may result in assets, but it excluded such costs because measurements of the amounts that should be allocated to advertising are too imprecise. The costs of materials bought from a supplier in the production of advertising materials should be reported as costs of assets from direct-response advertising if those materials can be directly attributed to specific direct-response advertising. An example of such costs and activities is the cost of paper bought from a third party used to produce catalogues.

Amortization

.79 APB Opinion 17, paragraph 32, states that intangible assets should be amortized using the straight-line method, unless a company demonstrates that another systematic method is more appropriate. AcSEC used FASB Statement No. 86 as a basis for determining the amortization method because it believes the method used in that Statement generally is more appropriate. AcSEC does not require straight-line amortization, because the benefits of advertising sometimes are greater or less in future periods than in current periods. AcSEC believes amortization should match the costs of obtaining the future benefits with those benefits.

.80 In calculating the amortization of the amounts reported as assets resulting from direct-response advertising, the amounts in the calculation should not be discounted to net present value. The FASB currently is studying discounting. Under current generally accepted accounting principles (GAAP), assets resulting from direct-response advertising are nonmonetary assets, and nonmonetary assets generally are not discounted. Further, the effect of discounting generally would not be material, because the amortization period usually would be short.

.81

Appendix

Other Financial Reporting Literature

The following sets forth relevant portions of authoritative and other financial reporting literature that was considered by AcSEC in its deliberation of financial reporting on advertising activities.

As discussed in paragraph .06 of this SOP, the guidance in this SOP does not apply to transactions for which pronouncements in category (a) in paragraph 10 of SAS No. 69 provide guidance.

Guidance Included in Category (a) in Paragraph 10 of SAS No. 69

APB Opinion 17

APB Opinion 17, *Intangible Assets*, paragraph 24, states the following:

> . . . [A] company should record as assets the costs of intangible assets acquired from other enterprises or individuals. Costs of developing, maintaining, or restoring intangible assets which are not specifically identifiable, have indeterminate lives, or are inherent in a continuing business and related to an enterprise as a whole—such as goodwill—should be deducted from income when incurred.

However, paragraph 28 states that "a reasonable estimate of the useful life may often be based on upper and lower limits even though a fixed existence is not determinable."

APB Opinion 28

APB Opinion 28, *Interim Financial Reporting*, paragraph 15(a), states the following:

> Costs and expenses other than product costs should be charged to income in interim periods as incurred, or be allocated among interim periods based on an estimate of time expired, benefit received or activity associated with the periods. Procedures adopted for assigning specific cost and expense items to an interim period should be consistent with the bases followed by the company in reporting results of operations at annual reporting dates. However, when a specific cost or expense item charged to expense for annual reporting purposes benefits more than one interim period, the cost or expense item may be allocated to those interim periods.

Paragraph 16(d) states the following:

> Advertising costs may be deferred within a fiscal year if the benefits of an expenditure made clearly extend beyond the interim period in which the expenditure is made. Advertising costs may be accrued and assigned to interim periods in relation to sales prior to the time the service is received if the advertising program is clearly implicit in the sales arrangement.

FASB Statement No. 2

FASB Statement No. 2, *Accounting for Research and Development Costs*, provides no specific guidance on the financial reporting treatment of advertising but does include a discussion from which parallels can be drawn. Appendix B, "Basis for Conclusions," includes uncertainty of probable future benefits, lack of causal relationship between expenditures and benefits, and measurability of probable future economic benefits as bases for the FASB's conclusion that the costs of research and development should be reported as expenses when incurred and, in effect, that the benefits of that activity should not be reported as assets. The FASB considered the concept of selective reporting of assets for those activities, which would involve establishing conditions that would have to be met before the benefits of research and development could be reported as assets. However, because the factors on which such conditions might be based could not be objectively and comparably applied by all enterprises, the FASB rejected this concept for research and development activities.

The Statement, in paragraph 11, includes both internal and external costs among the costs to be identified with research and development activities.

FASB Statement No. 13

FASB Statement No. 13, *Accounting for Leases*, as amended by FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, paragraph 24, states that "*initial direct costs* shall not include costs related to activities performed by the lessor for advertising [and] soliciting potential lessees . . ." and therefore requires that the costs of advertising, as they pertain to leases, be reported as expenses when incurred.

FASB Statement No. 19

FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, is discussed in the "Discussion of Conclusions and Implementation Guidance" section of this SOP.

FASB Statement No. 51

FASB Statement No. 51, *Financial Reporting by Cable Television Companies*, appendix A, paragraph 17, states that "direct selling costs include . . . local advertising targeted for acquisition of new subscribers . . ." and requires that they be reported as expenses when incurred, but initial hookup revenue may be recognized to the extent such costs are incurred.

FASB Statement No. 53[9]

FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*, requires in paragraph 15 that the probable future economic benefits of exploitation activities, including prerelease and early-release advertising of films in both primary and secondary markets that probably will benefit the film in future markets, be reported as film inventory at cost and amortized based on the ratio that gross revenues from the film for the current period bear to total anticipated gross revenues from the film during its useful life. The costs of local advertising that is "not clearly expected to benefit the film in future markets . . . shall be charged to expense in the period incurred."

FASB Statement No. 60

FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, requires in paragraph 29 that the probable future economic benefits of policy acquisition activities be reported as assets at cost and amortized in proportion to premium revenue reported. Appendix A, paragraph 66, defines acquisition costs as—

[9] In 2000, the FASB rescinded FASB Statement No. 53 and AcSEC issued SOP 00-2, *Accounting by Producers or Distributors of Films* [section 10,800]. The provisions of this SOP apply to entities within the scope of SOP 00-2 [section 10,800]. [Footnote added, effective for financial statements for fiscal years beginning after December 15, 2000, by Statement of Position 00-2.]

> Costs incurred in the acquisition of new and renewal insurance contracts. Acquisition costs include those costs that vary with and are primarily related to the acquisition of insurance contracts (for example, agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees).

The Statement does not discuss whether acquisition activities include advertising activities.

FASB Statement No. 67

FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, appendix A, paragraph 28, defines the following terms:

> *Costs Incurred to Rent Real Estate Projects*
>
> Examples of such costs include costs of model units and their furnishings, rental facilities, semipermanent signs, rental brochures, advertising, "grand openings," and rental overhead including rental salaries.
>
> *Costs Incurred to Sell Real Estate Projects*
>
> Examples of such costs include costs of model units and their furnishings, sales facilities, sales brochures, legal fees for preparation of prospectuses, semipermanent signs, advertising, "grand openings," and sales overhead including sales salaries.

The probable future economic benefits of activities undertaken to sell real estate projects are reported as assets at cost if their costs are realizable from the sale of the project and are incurred for tangible assets that are used throughout the selling period to help sell the project. Paragraph 19 states that "capitalized selling costs shall be charged to expense in the period in which the related revenue is recognized as earned."

Paragraphs 20 and 21 state:

> If costs incurred to rent real estate projects, other than initial direct costs, under operating leases are related to and their recovery is reasonably expected from future rental operations, they shall be capitalized. Examples of such costs are costs of model units and their furnishings, rental facilities, semipermanent signs, "grand openings," and unused rental brochures. Costs that do not meet the criteria for capitalization shall be expensed as incurred, for example, rental overhead.
>
> Capitalized rental costs directly related to revenue from a specific operating lease shall be amortized over the lease term. Capitalized rental costs not directly related to revenue from a specific operating lease shall be amortized over the period of expected benefit. The amortization period shall begin when the project is substantially completed and held available for occupancy. Estimated unrecoverable amounts of unamortized capitalized rental costs associated with a lease or group of leases shall be charged to expense when it becomes probable that the lease(s) will be terminated. [*Footnote reference omitted.*]

FASB Statement No. 86

FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*, provides no specific guidance on reporting on advertising, but it does provide guidance from which parallels can be drawn. Under the Statement, all costs incurred internally to create computer software products are reported as expenses when incurred until technological feasibility has been established for the products. For certain production costs of specific activities whose probable future benefits are reported as assets, paragraph 8 states:

> The annual amortization shall be the greater of the amount computed using (*a*) the ratio that current gross revenues for a product bear to the total of current

> and anticipated future gross revenues for that product or (*b*) the straight-line method over the remaining estimated economic life of the product including the period being reported on.

The unamortized amount of assets reported is compared to their net realizable value at the reporting date and is written down to the extent that it exceeds the net realizable value.

FASB Statement No. 91

FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, requires the probable future economic benefits of direct loan origination activities to be reported as assets at cost, which should be amortized over the lives of the loans with the amortization reported as yield adjustments. Paragraph 6 states that "direct loan origination costs of a completed loan shall include only (*a*) incremental direct costs of loan origination incurred in transactions with independent third parties for that loan and (*b*) certain costs directly related to specified activities performed by the lender for that loan." Those specified activities do not include advertising or marketing. Paragraph 7 states that "all other lending-related costs, including costs related to activities performed by the lender for advertising [and] soliciting potential borrowers . . . shall be charged to expense as incurred."

Guidance That Is Not Included in Category (a) of Paragraph 10 of SAS No. 69 but That Is Not Affected by This SOP

Industry Audit Guide *Audits of Stock Life Insurance Companies*

Paragraphs 8.27 to 8.30 of the AICPA Industry Audit Guide *Audits of Stock Life Insurance Companies* state that acquisition expenses should be deferred only if the expense both varies with and is primarily related to the production of new business. Paragraph 8.30 of the guide states that advertising activities are acquisition activities.

Advertising activities that are policy acquisition activities should continue to be accounted for in conformity with the guidance in FASB Statement No. 60 and *Audits of Stock Life Insurance Companies.*

Audit and Accounting Guide *Audits of Property and Liability Insurance Companies*

Paragraphs 3.34 and 8.13 of the AICPA Audit and Accounting Guide *Audits of Property and Liability Insurance Companies* state that acquisition costs that vary with and are primarily related to the acquisition of new and renewal business should be capitalized as deferred acquisition costs. The guide does not state whether advertising activities are acquisition activities.

Advertising activities that are policy acquisition activities should continue to be accounted for in conformity with the guidance in FASB Statement No. 60 and *Audits of Property and Liability Insurance Companies*.

FASB Technical Bulletin No. 90-1

FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*, discusses advertising costs incurred in connection with acquiring extended warranty and product maintenance contracts. Paragraph 4 states the following:

> Costs that are directly related to the acquisition of a contract and that would have not been incurred but for the acquisition of that contract (incremental di-

rect acquisition costs) should be deferred and charged to expense in proportion to the revenue recognized. All other costs, such as . . . advertising expenses . . . should be charged to expense as incurred.

Guidance That Is Not Included in Category (a) of Paragraph 10 of SAS No. 69 That Is Amended by This SOP

SOP 88-1

AICPA SOP 88-1, *Accounting for Developmental and Preoperating Costs, Purchases and Exchanges of Take-off and Landing Slots, and Airframe Modifications*, paragraphs 19 to 24 [section 10,430.19–.24], amends *Audits of Airlines* by recommending that the probable future economic benefits of developmental activities not be reported as assets, "because of the current deregulated environment and the uncertainty regarding the recoverability" of the costs of such activities. The SOP states that the basis for the conclusion in the guide was that the airline industry operated in a regulated environment and "the expected future benefit and recoverability of such costs was generally not in doubt . . . . Route expansion or alteration has become a recurring activity among the airlines, and any related cost is considered a normal and recurring cost of conducting business."

Paragraph 51 of this SOP discusses amendments to SOP 88-1 [section 10,430.51].

SOP 89-5

Paragraphs 50 to 54 of SOP 89-5, *Financial Accounting and Reporting by Providers of Prepaid Health Care Services*, discuss accounting for contract acquisition costs. Paragraph 51 lists advertising as one kind of contract acquisition cost. Paragraph 54 states that ". . . acquisition costs of providers of prepaid health care services should be expensed as incurred."

Paragraph 52 of this SOP discusses amendments to SOP 89-5.

SOP 90-8

Paragraph 65 of SOP 90-8, *Financial Accounting and Reporting by Continuing Care Retirement Communities*, states the following:

> Costs of acquiring initial continuing-care contracts that are expected to be recovered from future contract revenues should be capitalized. These costs should be amortized to expense on a straight-line basis over the average expected remaining lives of the residents under contract or the contract term, if shorter. Costs of acquiring continuing-care contracts after a CCRC [continuing-care retirement community] is substantially occupied or one year following completion should be expensed when incurred.

Paragraph 15 states that advertising is not a cost of acquiring an initial continuing-care contract.

Some believe that SOP 90-8 includes no guidance for reporting the costs of advertising activities. Others believe that the exclusion of advertising activities from the definition of the costs of acquiring an initial continuing-care contract is a prohibition against capitalizing advertising under the guidance in paragraph 63.

Paragraph 53 of this SOP discusses amendments to SOP 90-8.

Accounting Standards Executive Committee (1992-1993)

Task Force on Reporting on Advertising Activities and Certain Other Activities Undertaken to Create Intangible Assets

AICPA Staff

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