

FRS Alert

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SJ Grant Thornton
Malaysia

Advertising and promotional costs

Accounting for expenditure on advertising and promotional activities, including:

- promotional catalogues and brochures; and
- media advertising.

This FRS Alert does not address website content development costs. The specific guidance in IC Interpretation 132 Intangible Assets – Web Site Costs should be followed for these costs.



Guidance

Expenditure on advertising and promotional activities should be written off as incurred (FRS 138.69). In applying this requirement, our preferred view is that costs are treated as incurred when the related development activities are performed. Therefore:

- **promotional catalogues and brochures** are **not** recorded as inventory or other assets; and
- costs incurred in **developing an advertising campaign** are recorded as expenses as the development activities are performed.



It is also acceptable to defer expensing such costs until the advertising or promotional matter is consumed. This is an accounting policy choice. It is not appropriate to defer the recognition of the expense until the period(s) in which the entity expects to generate sales.

Discussion

FRS 138.69(c) requires that advertising and promotional costs are expensed “as incurred”. This is because, although the entity expects to derive future benefits from advertising and similar activities, no intangible or other asset is created (FRS 138.69). FRS 138 does not however preclude recognising a prepayment when payment has been made in advance of delivery of good or services (FRS 138.70). The issue covered in this FRS Alert relates to when advertising and similar costs are considered to be “incurred”.

Costs are incurred when the related development services or activities are performed. Services and activities are often performed before the advertising or promotional campaign is deployed. An entity might use an external advertising agency to develop an advertising campaign. Under our preferred view, costs associated with developing the campaign are incurred as those services are provided, not (for example) when the advertisement is broadcast. Hence, an expense is recorded as the agency provides the development services.

We also consider that FRS 138.70 allows an entity to recognise a prepayment in situation where it has paid for goods and services but has not yet received those goods and services. An alternative view is that such costs are incurred when the advertising or promotional matter is **consumed**. Under this view, it is acceptable to:

- recognise promotional catalogues and brochures on the balance sheet as inventory or other assets and write the amounts off to the income statement on despatch of the catalogues to customers; and
- defer costs relating to developing an advertising campaign until these development costs are utilised in the advertising campaign.

We refer to the International Financial Reporting Interpretations Committee (IFRIC), which has been discussing this issue. The IFRIC has tentatively indicated that it will not develop a formal interpretation. However, in its draft rejection notice the IFRIC stated that:

“ IFRIC noted that, if it did not pursue any changes, then divergence was likely to continue to exist around the wording of paragraph 70 of IAS 38 (which is identical to paragraph 70 of FRS 138) and the treatment of pre-payments, and it asked the staff to develop amendments to paragraphs 68-70 of IAS 38 (which is identical to paragraphs 68-70 of FRS 138) to clarify that **advertising costs may be deferred until they are consumed**. The IFRIC also discussed mail order catalogues. The IFRIC reaffirmed its view that such catalogues are forms of advertising.”

On the basis of IFRIC’s comments, we consider that either of the approaches described above is acceptable. This is a matter of accounting policy choice. As with all policy choices, management should select the most relevant policy, apply it consistently and disclose it, if significant. However, our preference is not to defer advertising costs. This is because we believe it is questionable that such costs give rise to an asset. Moreover, if an entity applies a policy of cost deferral, a further issue arises as to the period over which such costs are considered to be consumed.

Although costs may be deferred until the advertising is consumed, certain practices aimed at matching the expense with the expected additional sales or other benefits are not acceptable. For example, In the fashion industry, entities may incur promotional costs relating to future seasons’ clothing. It is acceptable to defer costs until the advertising is consumed. It is not acceptable to defer these costs until the clothing ranges are on sale.

Applicability

FRS 138 is applicable to an entity that:-

- Is not a private entity as defined in Section 15(1) of Companies Act, 1965, in this case Private Entity Reporting Standards (PERS) are to be applied;
- Is required to prepare or lodge any financial statements under any law administered by Securities Commission or Bank Negara Malaysia; or
- Is a subsidiary or associate of, or joint venture controlled by, an entity which is required to prepare or lodge any financial statements under any law administered by Securities Commission or Bank Negara Malaysia.

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