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**International  
Accounting Standards  
Board**

*This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.*

*Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.*

## **INFORMATION FOR OBSERVERS**

**IFRIC meeting:** September 2006, London

**Project:** Treatment of catalogues and other advertising costs  
(Agenda Paper 7)

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## **INTRODUCTION**

1. In June 2006, the IFRIC received a request for an Interpretation giving guidance on the treatment of certain advertising and marketing costs.
2. The request considered the treatment of costs incurred by mail order companies in developing and printing catalogues as a distinct distribution channel. It requested guidance as to how these costs should be treated when the catalogues have been delivered to the mail order company but have not yet been delivered to the customer.
3. The request also asked for guidance which may assist in other analogous situations. For example, how costs incurred in producing TV spots including production costs, advertising agency fees, commissions for models, etc should be accounted for when these services have been received by an entity but when the TV spot has not yet been broadcast.

4. At its August meeting, the IFRIC Agenda Committee continued its discussions on the issue. Agenda Committee members expressed a view that there was divergence in the way that IAS 38.70 (which discusses prepayments) is applied to catalogues.
5. Agenda Committee members believed that if catalogue costs were considered alone, then it would be unlikely that the divergence would be sufficient to be considered to have widespread significance. On the other hand, if all prepayments were considered then there would be likely to be significant divergence in the way that IAS 38.70 was interpreted, but the issue may be so wide that the IFRIC would be unable to reach a conclusion on a timely basis.
6. The Agenda Committee therefore asked the staff to investigate whether a scope could be developed for a project which would consider the application of IAS 38.70 to a wider set of circumstances than just catalogues but not to the whole range of possible prepayments.
7. This paper is intended to provide an update to the IFRIC on the Agenda Committee deliberations to date, and allow the IFRIC to discuss whether it agrees with pursuing the development of a scope for a project as described above.

#### **SUMMARY OF THE ISSUE SUBMITTED TO THE IFRIC**

8. The submission to the IFRIC considered costs which had been incurred before the period end to develop catalogues or create TV slots but where the catalogues or TV slots had not been distributed to customers at that point. There are at least three views as to how these costs should be treated.

#### ***View 1 – Capitalisation and amortisation as an intangible asset***

9. Supporters of this view argue that the benefits of the catalogues flow to the entity over a period of time. Expensing the costs as incurred fails to recognise the asset which the future benefit of the catalogues represents.
10. They also point to the fact that the entity has intellectual property rights over the catalogues, as well as rights over parts of the content (for example the photographs). The catalogues therefore meet the definition of an intangible

asset under IAS 38 including identifiability (IAS38.8 and IAS38.12) and control (IAS38.8 and IAS38.13).

11. Supporters of View 1 also draw an analogy with SIC32.8 which states that “a web site arising from development shall be recognised if, and only if, in addition to complying with the general requirements described in IAS38.21 for recognition and initial measurement, an entity can satisfy the requirements in IAS38.57. In particular, an entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits in accordance with IAS 38.57(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed....”
12. If a website that is capable of generating revenues, including direct revenues from enabling orders to be placed, can meet the definition of an intangible asset, then a catalogue identifying prices, descriptions and codes of products and services, through which customers place orders, can also satisfy those conditions. Both are distribution channels.

***View 2 – Capitalisation as inventory with expense when distributed to customers***

13. Supporters of View 2 believe that these costs should be capitalised within inventory. They point to IAS2.6(c) which states that inventories are “assets ... in the form of materials or supplies to be consumed in the production process or in the rendering of services.”
14. They draw a parallel with other items such as office supplies, stationery etc which may be included within inventory until used. Additionally, supporters of View 2 consider that, if stationery can be included within inventory, it would not be correct to recognise the cost of the stationery as an expense at the point at which it becomes part of a catalogue and therefore moves closer to generating revenue for the entity.
15. In addition, supporters of this view note that under US GAAP SOP93-7.32, expenses incurred in respect of brochures, catalogues etc may be included in the balance sheet as an asset and expensed at the point at which the catalogues are distributed to customers.

### ***View 3 – Expense as incurred***

16. Supporters of this view argue that expenditure on the development of a catalogue or a TV spot should be charged to the income statement as incurred.
17. They point to IAS38.69, which states “In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, except when it forms part of a business combination, expenditure on research is always recognised as an expense when it is incurred (see paragraph 54). Examples of other expenditure that is recognised as an expense when it is incurred include: ... (c) expenditure on advertising and promotional activities.”
18. IAS38.70 states that “paragraph 68 does not preclude recognising a prepayment as an asset when payment for delivery of goods or services has been made in advance of the delivery of goods or the rendering of services.” In other words, the costs can only be deferred in the balance sheet until delivery of the goods and services to the entity.
19. Proponents of this view would also point to SIC32.8 which states “...an entity is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site shall be recognised as an expense when incurred.”

### **STAFF ANALYSIS**

20. The staff considers that while there are similarities between TV spots and catalogues, the two differ in certain key respects. The staff has therefore focussed its initial analysis on the treatment of catalogues, and then addressed the treatment of TV spots separately.

#### **Catalogues**

##### *Determining the accounting model for catalogues*

21. IAS 2.6 defines inventories as “assets :
  - (a) held for sale in the ordinary course of business;

- (b) in the process of production for such sale; or
  - (c) in the form of materials or supplies to be consumed in the production process or the rendering of services.”
22. In some circumstances, catalogues are sold by catalogue companies, and in these cases, the catalogues may be considered as being “held for sale in the ordinary course of business”. In these cases, the staff considers that IAS 2 requires the catalogues to be classified as inventory and accounted for under IAS 2 *Inventories*. These catalogues should be held in the balance sheet at the lower of cost and net realisable value.
23. To the extent that catalogues are not sold to customers, they are not held for sale in the ordinary course of business, in the process of production for such sale or in the form of materials or supplies to be consumed in the production process. These catalogues do not therefore meet the definition of inventories.
24. The costs of developing a catalogue will comprise a number of differing items including :
- a) costs of taking pictures, hiring models, etc;
  - b) costs of ‘writers’ to produce item descriptions, text etc;
  - c) printer costs, including the costs of transferring pictures, item descriptions and text onto a printed version;
  - d) stationery, paper, ink etc; and
  - e) design of a template for the catalogue.
25. Whilst some of the catalogue costs (for example the creation of templates) may be used during more than one period, catalogues typically have a relatively short life. The items which may be used for more than one period are typically intangible items, for example templates, descriptions or photographs. The staff does not therefore consider that catalogues can be considered as being items of property, plant and equipment as these are defined as being both ‘tangible’ and ‘expected to be used in more than one period.’
26. The staff considers that many of the costs described above are clearly advertising costs. For example, costs associated with taking photographs of an

entity's products and putting them in a format for use in a catalogue are exactly the same in nature as costs associated with taking photographs for use on a selling website. The IFRIC has previously concluded in SIC 32.9 that the cost of such photographs is an advertising and promotional cost.

27. IAS 38.8 defines an intangible asset as an "identifiable non-monetary asset without physical substance". IAS 38.5 states that "this standard applies to, amongst other things, expenditure on advertising." It states that "although these activities may result in an asset with physical substance (eg a prototype), the physical element of the asset is secondary to its intangible component". SIC 32 also concludes that a website which may be used for selling and advertising in a similar way to a catalogue is an internally generated intangible asset and should be accounted for under IAS 38.
28. In the light of the above, the staff believes that a catalogue is an intangible asset if it can be shown that the physical element (ie the paper that the catalogue is printed on) is secondary to the intangible element.
29. The staff considered the example of a catalogue which is used for mail order shopping and has an associated website, for example Kays, Freemans, ezibuy, etc. In these situations, a customer may either request a catalogue or may view almost identical information on the internet. The staff considers that for both the customer and the catalogue company, the advertising and promotional content is the primary focus, with the method of delivery being more a matter of convenience to the customer.
30. The staff therefore believes that the physical catalogue used to deliver the advertising is secondary to the intangible promotional and advertising element of the catalogue cost and, as such, that the catalogue should be accounted for as an intangible asset under IAS 38.

*Determining the accounting treatment for catalogues*

31. IAS 38.69(c) details types of expenditure which should be recognised as an expense as incurred. It states that "examples of expenditure that is recognised as an expense when it is incurred include...expenditure on advertising and promotional activities."

32. SIC 32.9 states that, when IAS 38.69(c) is applied to websites, “to the extent that content is developed to advertise or promote an entity’s own products and services (eg digital photographs of products), shall be recognised as an expense when incurred.”
33. The staff consider that it is clear that IAS 38.69 (c), especially when read in the context of SIC 32, requires that costs of taking digital photographs for a catalogue, hiring models, developing content, developing descriptions, and transferring those items into a format suitable for use by a printer should be expensed as incurred ie when those items or services are received by the entity.
34. Furthermore, the staff considers that costs associated with the development of templates for the catalogue, including logos, typefaces, and costs incurred to ensure that the catalogue embodies the corporate identity of the catalogue company are costs of developing the company’s brand. IAS 38.63 states that “Internally generated brands, mastheads, publishing titles, customer lists and items similar shall not be recognised as intangible assets.”
35. The staff therefore concludes that the catalogue costs should be recognised as an expense as incurred.

*When is a cost incurred?*

36. As discussed above, the staff believes that the costs of printing and developing catalogues should be expensed as incurred. In considering when the cost is incurred, the staff notes IAS 38.70 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.” The staff also notes SIC32.9(c) which interprets IAS 38.69(c) to say “expenditure shall be recognised as the professional services are received during the process, not when the digital photographs are displayed”.
37. The staff therefore concludes that expenditure on catalogues is incurred at the point at which the services to produce the catalogues are provided to the entity. For example, in the case of taking photographs, when the photographs are received by the entity, in the case of printing, when the printing is completed, etc.

## **TV slots**

38. The staff considers that there is a wide range of differing types of TV slots ranging from brand advertising, to product advertising offering a phone number which can be dialled to order the product, to interactive TV slots to sell a product.
39. The staff considers that it is clear that most forms of advertising and promotional activity should be expensed as incurred in accordance with IAS 38.69 (c), which states that “examples of expenditure that is recognised as an expense when it is incurred include ... expenditure on advertising and promotional activities.”
40. In line with the treatment of catalogue costs discussed above, the staff considers that, for a TV slot which is used as a direct selling medium, some of the costs incurred will relate to advertising and promotional activities and these should be expensed as the service is received by an entity (for example, if an entity contracts an advertiser to produce an advert, they should recognise the cost as an expense when the ‘tape’ is received from the agency.)
41. Where an entity has paid the cost of communicating advertising, for example, it has paid for a 10 minute slot but has not yet transmitted, the staff considers that IAS 38.70 is clear in requiring the related cost to be deferred on the balance sheet as a prepayment until transmission takes place.
42. In the situation where a TV slot is used in direct selling, which is broadcast live as part of a selling effort, the cost of the live presenters and live promotion will be incurred as the show is broadcast. The cost of these advertising and promotional activities should also be expensed as incurred.

## **CONSIDERATION OF WHETHER THE IFRIC SHOULD TAKE THE ISSUE ONTO ITS AGENDA**

### *Significantly divergent interpretations*

43. The submission received by the IFRIC noted that differing interpretations did exist in practice and that these resulted in differing cost recognition profiles between entities.

44. [Paragraph omitted from observer note].
45. Whilst the above is not conclusive, the staff considers that this does support the view that divergence exists in practice.
46. In contrast, catalogues will tend to be produced at regular intervals (for example quarterly, half-yearly, annually etc). It may therefore be argued that whilst there may be a material effect on adoption of a different accounting treatment, the impact on annual profit may not be material.
47. Additionally, the fact that a lot of catalogue companies do not disclose a specific accounting policy relating to catalogue costs may indicate that the costs carried forward are not material.
48. The staff therefore conclude that whilst there does appear to be divergence in practice in the way that catalogue costs are treated on the balance sheet, this divergence may not be significant if limited to the case of catalogues on its own.

*Practical and widespread relevance*

49. Catalogues are used by a wide range of businesses and charities as a distribution channel for their goods. Interpretive guidance in this area is likely to have an impact on a wide number of these organisations.
50. On the other hand, the cost of such catalogues and the time span between committing to spend and distributing the catalogues may be small, so the impact on individual entity year end financial statements may be reduced.

*Relationship with a Board project*

51. The issue is unlikely to be addressed by a Board project in the immediate future.

*Likely to result in a consensus of the IFRIC*

52. As discussed above, if a project is taken on to consider all prepayments, then the staff considers that the IFRIC is unlikely to be able to reach a consensus in a reasonable timeframe. If a sufficiently narrow scope can be developed, then the staff considers that there is sufficient extant guidance for the IFRIC to be able to reach a consensus on the issue in a reasonable timeframe.

[Paragraphs 53-57 omitted from observer note, together with draft conclusions].