Advertising and sponsorship

Accounting for promotional costs in consumer products companies under IFRS
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Marketing and promotion activities in consumer products companies

Consumer products companies (CP companies) invest significant time and effort in marketing and promoting their products and brands. The typical annual expenditure by companies in our recent Consumer products IFRS financial statements survey represented more than 10% of the annual revenue of those companies1. Marketing and promotional activities include advertisements in print media, TV/radio and internet spots, extensive advertising campaigns, sponsorship agreements with celebrities, sponsorship of events and locations and delivery of marketing and promotional materials to customers. It is clear that the expenditures incurred by CP companies on marketing and advertising can be very significant and, in many cases, relate to campaigns that run over a number of years.

Whilst the commercial benefit of these activities may be obvious, it is often more difficult to determine how the expenditures should be treated in the financial statements. Although the contractual arrangements are usually specific to each case, management needs to carefully consider the following issues:

- Do the contractual agreements relate only to advertising and promotional activities, or do they give rise to separate intangible or other assets to be recognised?
- When should the costs incurred be recognised?
- How should the obligations from the contractual arrangements be measured?

Recent pronouncements issued by the IASB have given some clarity to these accounting issues and experience so far has shown that more advertising and promotional costs must be recognised earlier. Even where the changes have not impacted the accounting outcome for these costs, entities have had to invest significant time and effort to assess the impact and have had to make changes to information systems to capture data effectively as a result.

This publication discusses the principles relating to advertising and promotional costs and gives some practical examples to demonstrate the thought process that management will need to undertake to find a sound accounting treatment for these often complex issues.

General principles

IAS 38 Intangible Assets requires expenditure on advertising and promotional activities to be expensed as the costs are incurred. Such costs enhance the entity’s brands and customer relationships, which, in turn, generate revenues. However, the assets and services received for use in advertising do not embody separable economic benefits and so do not give rise to separate assets.

IAS 38 has always required entities to recognise costs arising from advertising and promotional activities as an expense when the expenditure is incurred in the application of the standard. However, the term ‘when incurred’ has been interpreted in different ways, leading to diversity in practice.

To address this, the IASB amended IAS 38 as part of its Annual Improvements process in 2008. The amendments clarified that, in the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods and, in the case of the supply of services, the entity recognises the expenditure as an expense when it receives the services. The amendments further specified that an entity has a right to access goods when it owns them. Similarly, an entity has a right to access goods when they have been constructed by a supplier in accordance with the terms of a supply contract and it may demand delivery of them in return for payment. Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity, and not when the entity uses them to deliver another service.

IAS 38 is clear that advertising and promotional costs do not give rise to intangible assets. However, the standard does not preclude the recognition of a prepayment where goods or services are paid for before the goods are delivered to, or the service is received by, the entity. Therefore, CP companies that enter into advertising and marketing contracts over a number of years can recognise a prepayment for costs paid up-front that relate to goods and services to be received at a later date.

In certain cases, contractual agreements may give rise to other assets that meet the recognition criteria for capitalisation as intangible assets, although this is expected to occur rarely. In these cases, entities will need to consider whether the asset meets the recognition criteria of IAS 38.

When expensing advertising and promotional costs, entities will also need to consider where they should be recognised within profit or loss. Neither IAS 38 nor IAS 1 Presentation of Financial Statements prescribes which category of expenses these costs fall into. Therefore, entities need to determine, on a consistent basis, where they should be recognised.

1 Ernst & Young Consumer Products IFRS financial statements survey 2009.
Putting the principles into practice
When accounting for marketing and promotional arrangements, management needs to perform the following steps:

- Identify the assets, rights and services embodied in the related contract
- Separate advertising content from other content (e.g., licences)

- Determine the timing of the advertising services rendered/assets delivered
- Determine and attribute the expenditures to the different services/assets received

This analysis, which is illustrated in the following decision tree, will be based on the facts and circumstances of each arrangement.

**Decision tree**

1. **Identify the assets and services in the contract**
2. **Separable rights**
   - **Advertising and promotional costs**
3. **Do the rights meet the definition of an intangible asset?**
   - **Yes**
     - Capitalise the asset
   - **No**
     - **Have the goods or services been received?**
       - **Yes**
         - Expense cost immediately
       - **No**
         - **Is it probable that future economic benefits will flow to the entity and can the cost of the asset be measured reliably?**
           - **Yes**
             - Expense cost immediately
           - **No**
             - **Have the good or services been received?**
               - **Yes**
                 - Expense cost immediately
               - **No**
                 - Recognise a prepayment until the goods or services are received
When an entity recognises a separable right, the following issues need to be considered:

- When is the asset recognised? For example, an entity may purchase a licence that only starts in one year’s time. Therefore, the entity may need to recognise a prepayment for amounts paid before the intangible asset is received. Likewise, an entity may receive the intangible asset but payment is not due until a later date, in which case, the entity would recognise a liability for the amount due.

- Intangible assets must be amortised if they have a finite useful life. If the useful life cannot be determined, the asset must not be amortised, but must be tested for impairment annually in accordance with IAS 36 *Impairment of Assets*.

In many cases, entities may enter into contracts that include both separable rights and advertising and promotional costs. In this case, entities will need to allocate the cost to the different components of the contract. This may be difficult to do in practice and we have considered this in more detail in the examples beginning on the following page.

**Impact on typical activities undertaken by CP companies**

CP companies typically undertake different types of advertising and promotional activities. In this section, we apply the general principles listed above to some examples of common activities undertaken in practice. The activities we have addressed are:

- **Section 1**: Advertisements
- **Section 2**: Celebrity sponsorship
- **Section 3**: Event and location sponsorship
- **Section 4**: Promotional goods given to customers

**Conclusion**

The advertising and marketing activities undertaken by CP companies are often extensive and involve complex contracts that include many different goods and services. The clarifications to IAS 38 may help entities to assess when those goods and services are received and hence when the costs should be expensed. However, due to the individual nature of each contract, management judgment is still required to identify the goods and services embodied therein, the allocation of the expenditures to these goods and services and the timing of their recognition.
Example 1: Advertisements

Standard marketing activities may consist of mailings, advertisements in print media, TV and continuous internet presence. The respective contractual agreements usually include a clearly identifiable service or asset and include only advertising and promotional costs. IAS 38 is clear that the costs must be expensed when the goods or services are received. However, the timing of the receipt of the goods and services may be unclear.

Analysis:

The diagram above shows the typical processes involved in developing, producing and distributing an advertisement. The vertical arrows indicate the timing of the expense recognition. The accounting implications of each process are outlined below.

Development and production

a) Separate contracting

In the development and production phase, the entity engages an advertising agency to conceptualise a television, radio or print media advertisement. The entity also engages two other companies to produce the material. As shown in the diagram above, the entity receives a service at three distinct points in time:

- On completion of the concept development
- On initial production of the advertisement
- On final production of the advertisement.

The entity recognises the related expenses at each point, when it has received the service or rights to access the products from each of the suppliers.
b) Agent relationships

i) The entity contracts an advertising agency to develop and produce the advertisement. In most cases, the entity retains control of the process and so the advertising company acts as an agent of the entity. The goods and services are expensed as the entity has access to those goods or services, similar to the separate contracting example above.

ii) In some circumstances, the agency may be obliged to deliver only the final product and engage other independent sub-contractors so that the entity only receives the completed advert at the end of the production process. Therefore, the costs are not expensed until the entity can access the completed advert.

The contractual arrangements and the substance of the relationship between the advertising agency and the CP company will determine whether the advertising company is acting as an agent of the CP company.

Placement

The placement of the advertisement to customers is independent from the production process and the expense recognition depends on the timing of the service received. As shown in the diagram, a mailing service may be performed at a discrete point in time. In this case, the distribution costs are expensed at the time the service is received. Television or radio broadcasts or adverts in print media are likely to occur at several discrete points in time and it may be appropriate to allocate the distribution costs to each broadcast or print distribution. A continuous internet presence may be a constant service up to a specified date, and so, the cost may need to be expensed over the entire period.

In each case, entities need to clearly establish the service that is being provided and the period over which it is provided, compared with when payment is made for the service, in order to determine the timing of the expense recognition and whether any of the expenditures should be recognised as a prepayment.

Special consideration may also need to be given to the purchase of materials for use in the placement of advertisements (for example, the purchase of blank paper for mailing production). If such raw materials have alternative uses, it may be appropriate to recognise them as inventory until they are printed, at which point the cost would be expensed. Alternatively, if they have no other value to the entity, immediate recognition of the expense is likely to be required.
Example 2: Celebrity sponsorship

Many CP companies use celebrities, such as athletes, models and actors to promote their brands and products. Contracts often cover a term of several years and may contain multiple performance obligations for the celebrity and several different payment obligations of the CP company.

Management will need to use judgment, based on the facts and circumstances within each contract, to identify the assets acquired and services received, the timing of the receipt of those goods and services, and the allocation of the expenditures to each element.

The following example of a celebrity sponsorship arrangement considers how this judgment may be applied:

Celebrity sponsorship example

Fact pattern:
Sports apparel company A enters into a three-year agreement with a tennis player who is currently ranked number 12 by the Association of Tennis Professionals (ATP) with the following characteristics:

- The player receives a signing bonus of CU 1,200
- The contract specifies that the player earns an annual retainer of CU 220, paid at the end of each year for three years, provided that the player has competed in all the specified tournaments for each year.

In return, the player is required to do the following:

- Exclusively wear A’s products and use A’s rackets in all official tournaments and wear A’s apparel in all public appearances outside the tournaments
- Play all Grand Slam tournaments and eight other ATP Masters tournaments each year
- Attend 4 one-day photo/film shoots for advertisements each year
- Attend 4 other one-day events to promote A’s products each year (e.g. fairs)
- Participate in developing tennis rackets (four days/year)
- Grant A the exclusive reproduction rights and use of the images, name and other personal characteristics (e.g., photos, voice) of the player for advertising and promotion campaigns
- The player must adhere to a code of conduct on and off the court

In addition to the signing bonus and annual retainer, the player receives the following additional payments:

- For winning a Grand Slam or ATP Masters, the player receives CU 150 and CU 100, respectively, and receives 50% and 25% of these amounts, respectively, for final and semi-final appearances
- The player receives additional payments of CU 500, CU 300 and CU 200 at the end of each year for an ATP ranking of number 1, in the top 5 or in the top 10, respectively
Analysis:

In this example, we have assumed the different payments (signing fee, annual retainer and additional payments) are not interrelated. However, in practice the different services and payments may be interrelated (e.g., low signing fees and high, but decreasing, annual retainers). Therefore, any interdependencies and interrelations between different forms of payments or specific services and payments have to be carefully examined in order to determine an appropriate expense recognition pattern. We have considered this concept further in the event sponsorship example later in this publication.

This contract relates to advertising and promotional expenditure to secure the endorsement of A’s brand by the celebrity tennis player. Therefore, in accordance with IAS 38, the costs must be expensed when the entity has received the service. Any amounts paid in advance of the service being received are recognised as prepayments and expensed when that service is received.

We have considered each of the payments in turn to determine when they should be recognised.

Signing bonus

The signing bonus of CU 1,200 is paid to the player on commencement of the contract. In return, the player is obliged to wear A’s apparel and use A’s equipment, take part in photo shoots and public appearances, permit the use of his/her name and image to promote A’s products, and adhere to A’s code of conduct over the three-year contract period. In these circumstances, the signing bonus relates to the full contract term and so A recognises a prepayment of CU 1,200 on commencement and expenses this on a straight line basis over the three-year contract period (i.e., CU 400 per annum).

However, if, from the terms of the contract, separate services could be identified and measured reliably, the entity would allocate the costs, respectively, and recognise expenses once the separate service is rendered. If the contract is terminated prior to the end of the three-year period, any amount not recovered from the player would be expensed immediately.

Annual retainer

The player receives the annual retainer at the end of each year, provided he has competed in all of the specified tournaments for that year (as listed in the box above). A has a contractual obligation to deliver cash to the player and, hence, recognises a financial liability during the period, which must be accounted for in accordance with IAS 39 Financial Instruments: Recognition and Measurement. The liability is recognised at the point that A has an obligation. Here, the obligation arises on the date when the player has competed in all the specified tournaments. Also at this point, the financial liability is recognised at the present value of the expected cash flows.

Additional payments

The player also receives additional performance-related payments for winning certain tournaments and achieving certain ATP rankings.

As these payments relate to specific events, they are treated as executory contracts. They are accrued and expensed when the player has won a tournament or achieved the ATP ranking.

This example illustrates some of the complexities CP companies face when they account for celebrity sponsorship contracts and demonstrates that an in-depth analysis of the terms of the contracts is required in order to develop an appropriate accounting policy.
Example 3: Event and location sponsorship

CP companies also sponsor particular events, such as the FIFA World Cup, the Olympics, specific tournaments, cultural and other events and locations, such as stadiums and arenas.

The respective sponsorship arrangements typically cover a term of several years (e.g. sponsorship of Olympiad 2008-12, Formula 1 sponsor for a three-year period, etc.), often encompassing multiple rights and obligations.

For all such arrangements, management needs to assess the contracts to determine the goods and services being received and the payments made. This may include separable rights that are not advertising and promotional costs, such as exclusive distribution rights of products at an event or in a location or the right to use the logo of the event. If the requirements of IAS 38 are met, these rights may be capable of separate capitalisation.

Entities need to consider in each case what service or right is being received, compared with when the payments are made and, in some circumstances, it may be appropriate to recognise a prepayment or intangible for those expenditures.

The following example illustrates some aspects of event sponsorships:

Event sponsorship example

Fact pattern:
Beverage CP company B enters into an agreement to produce an “Olympic energy drink” with the International Olympic Committee (IOC). The agreement has the following characteristics:

- Contract covers the Olympiad period from 1 September 2008 to 31 August 2012
- B is the exclusive supplier of beverages during the Olympic Games and in all official events during the Olympiad; B’s products have to be prominently placed in all official events
- B has the right to use the Olympic logo on its products during the Olympiad period
- B has the right to produce and sell an “Olympic energy drink” over the Olympiad period
- B has the right to place advertisements in all sport arenas during the Olympic Games 2012
- The IOC has to host the Olympic Games and to ensure the exclusivity status of B
- The IOC guarantees a free TV coverage of the event in at least 140 countries (covering 80% of world population) and certain viewing figures

B undertakes to:

- Pay a signing fee of CU 4,000
- Pay an annual retainer at the end of years 1, 2, 3 and 4 of CU 200, CU 400, CU 500 and CU 1,000, respectively
- Pay a revenue-based license fee for the “Olympic energy drink” of CU 2 per 1,000 units produced
- Provide beverages to all officials and athletes during the Olympic Games

Analysis:

Identification of rights

The first step is to identify whether the contract consists of advertising and promotional costs only, or whether there are other separable and identifiable assets. In the example, the exclusive supplier right and the right to use the Olympic logo and to produce the “Olympic energy drink” may be separable intangible assets. If the cost of these assets can be reliably measured, they may be recognised separately.

In this particular fact pattern, it is difficult to determine the cost of each different right obtained as the contract has been agreed as a whole. Therefore, the signing fee and the annual retainers cannot be reliably assigned to the different rights that B has obtained. As such, a separate intangible right is not recognised.
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Signing fee and annual retainer

A signing fee of CU 4,000 has been paid in return for the rights granted by the IOC. As the IOC has a number of obligations still to perform, such as ensuring the exclusivity of B, hosting the Olympic Games and ensuring TV coverage, the signing fee is recognised as a prepayment until these services are received, as discussed further below.

The annual retainer is paid at the end of each year. The signing fee and the annual retainer are interrelated. That is, the signing fee has been set at a high level and the annual retainer payments are set at a low and increasing level. Therefore, they should be considered together, spread out over different payment terms. The total amount of CU 6,100 (excluding any discounting effects) needs to be considered together to determine the appropriate expense recognition.

The timing of the expense recognition will depend on when B considers that it has received the services from the IOC. In practice, this is likely to be complex as B is receiving a number of different services over the four-year period. Furthermore, B has to determine how the total expenditures should be allocated to different services. This allocation exercise could be based on a relative fair value approach. Determining when the services are received and which expenses are to be recognised for each service will require significant judgment by management depending on the facts and circumstances.

For illustrative purposes, B has determined the following key elements of the service received from the IOC:

- Right to use the Olympic logo on all products for the four-year contract period
- Right to advertise the exclusivity of B’s sponsorship during the four-year contract period
- Placing advertisements on boards around the Olympic venues during the Games
- Placing products at the venues during the Games
- TV and press coverage in the periods preceding and during the Games.

Having analysed when the advertisements will be run and when the TV and press coverage will occur, B has determined that 40% of the service is received from the IOC when the Games are being held and so CU 2,440 is recognised as an expense during 2012. The remaining 60% is expensed on a straight line basis over the four years of the contract (15% or CU 915 each year) and represents the service B receives in the form of the ongoing promotion of the Games. B will recognise a prepayment for the signing fee and annual retainer until the services are received. As B has entered into a contract with the IOC over a number of years, B can obtain a benefit from that contract over its term. Therefore, any concentration of benefits in particular time periods will need to be clear from the terms of the contract and the way in which the benefits accrue to B.

As well as the payments to the IOC, B will also incur other costs, with other entities to produce the products and advertising materials. For example, the costs of designing and producing the advertisements that will be placed in the Olympic venues. In accordance with IAS 38, these costs are recognised when the service is received. Therefore, if the advertisements are produced in the year prior to the Games being held, the costs must be expensed at this time, not when the advertisements are shown.

Licence fee for the energy drink

The licence fee is payable when the drink is produced, although it may be paid on a monthly basis. The fee payable is expensed as a cost of sale (or part of the cost of inventory) when the drink is manufactured, as this is when it is due to the IOC.

Provision of beverages to officials and athletes

B is required to provide free drinks to officials and athletes during the Games. The cost of providing this may be considered to be part of the payment for the services received from the IOC, in which case, B will need to determine the cost of providing the free drinks and allocate this to the period in which the service is received. Alternatively, the service received may be the publicity of the officials and athletes consuming the drinks at the Games, in which case, the costs would be expensed over the course of the Games.

This example shows the need to analyse the terms of each contract in detail in order to determine an appropriate accounting policy.
Example 4: Promotional goods given to customers

Many CP companies, especially in the food and beverages and personal care sector, provide their customers with marketing and promotional materials ranging from samples (e.g., small perfume bottles that are distributed for free to the end customers) to long-lived assets (e.g., large umbrellas with the logo of the beverage brand used in garden restaurants or large advertising signs). These costs are usually expensed when the company has a right to access those goods, as it does not get any benefit from them other than marketing and brand promotion.

The following example illustrates some aspects of distributing promotional goods:

Promotional goods example

Fact pattern:

A cosmetics company manufactures shampoo and produces small sample bottles of a new product, that are given free to customers when they buy a full size shampoo bottle.

The company also purchases bespoke shelving, branded with the company logo, for displaying cosmetics. This shelving is given free of charge to retailers when certain product lines are ordered and is kept by the retailer until the end of its useful life.

Analysis:

Identification of rights

The sample shampoo bottles cannot be sold to customers and have no net realisable value to the company. The costs of producing the samples are expensed as they are manufactured.

The bespoke shelving is primarily for marketing purposes as it allows the retailer to display the company's products prominently. As the shelving has no other purpose and is not returned to the company, the costs of purchasing the shelving are expensed when the cosmetics company has a right to the asset.

In some limited circumstances, it may be appropriate to recognise an asset if there is a benefit to the company. For example, if a drinks manufacturer provides a chiller cabinet to a customer for a specified period of time, after which it is returned to the company and can be delivered to another customer, it may be appropriate to recognise this as property, plant and equipment.
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