

Insurance Spotlight

The Sun Sets on Direct-Response Advertising

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The Bottom Line

The Board discussion was swift and concise, resulting in a unanimous vote to eliminate direct-response advertising costs from acquisition costs potentially eligible for deferral.

- For an entity to defer direct-response advertising costs under the current guidance, the criteria initially outlined in SOP 93-7¹ (codified in ASC 340-20²) must be met and it must be probable that the deferral will result in future benefits.
- The accounting for direct-response advertising has been scrutinized as a result of deliberations on the revenue recognition and insurance contracts projects. In the revenue recognition project, the FASB has tentatively decided that only incremental costs should be deferred, thereby eliminating the criteria in ASC 340-20.
- Despite distinctions between the insurance contracts and revenue recognition projects, the FASB could not justify creating an industry exception; in the insurance contracts project, the Board unanimously rejected the inclusion of direct-response advertising, whether successful or unsuccessful, in acquisition costs being considered for deferral.
- The insurance contracts exposure draft is still expected to be issued in 2012; however, the final standard — and therefore the revised accounting treatment of direct-response advertising — is expected to be effective no earlier than January 1, 2016.

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¹ AICPA Statement of Position (SOP) 93-7, *Reporting on Advertising Costs*.

² For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

Beyond the Bottom Line

This *Insurance Spotlight* provides background information on direct-response advertising costs in the insurance industry, summarizes the FASB's recent decision affecting the future accounting for these costs, and gives insight into the decision's potential impact on insurers.

A Look Back at the History

SOP 93-7 defines advertising as "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." Direct-response advertising is a type of marketing that may be delivered through various mediums and is designed to generate an immediate response that can then be measured and attributed to the specific advertisements.

Advertising costs generally are expensed as incurred **except** in the case of direct-response advertising. At the time of issuance of SOP 93-7, the justification for this exception stemmed from the fact that the new business generated from the specialized advertisements would cover these costs. Since then, the FASB has issued ASU 2010-26,³ which aims to reduce diversity in practice in insurers' accounting for deferred costs. While ASU 2010-26 amended industry guidance on the deferral of certain costs incurred during the acquisition of new or renewal insurance contracts, it clarified that the ASC 340-20 criteria (which remain unchanged) must be met for direct-response advertising costs to be deferrable. ASU 2010-26 stated that "advertising costs should be included in deferred acquisition costs [DAC] only if" the following capitalization criteria for direct-response advertising costs in ASC 340-20 (formerly SOP 93-7) are met:

- The "primary purpose of the advertising is to elicit sales to customers who could be shown to have responded specifically to the advertising."
- The "direct-response advertising results in probable future benefits."

ASU 2010-26 clarified that any direct-response advertising costs capitalized in DAC are subject to the guidance in ASC 944 on subsequent measurement and impairment.

After issuing ASU 2010-26, the FASB tentatively decided to include direct-response advertising costs as acquisition costs in its joint insurance contracts project with the IASB.

The Board Discussion and Vote

On July 25, 2012, the FASB staff presented the background and issues associated with direct-response advertising to the Board as part of the deliberations in the insurance contracts project. The staff reminded the Board of two key items: (1) the previous decision to include direct-response advertising costs as acquisition costs in the insurance contracts project and (2) the subsequent decision made in the revenue recognition project to limit acquisition costs eligible for deferral to those that are incremental, thereby eliminating the current criteria in ASC 340-20. With those two previous decisions in mind, the FASB staff sought the Board's approval to introduce criteria similar to those in SOP 93-7 into the insurance contracts project and to explicitly limit those costs to successful efforts.

The Board's discussion was swift and concise, generating a virtual consensus at the outset, and resulted in a unanimous vote to reject the staff's proposal. Despite the staff's attempts to highlight differences between the insurance contracts and revenue recognition projects, the Board could not justify creating an industry exception over what was referred to as a "very fine and manufactured line" in light of previous decisions reached in the revenue recognition project.

Accounting for direct-response advertising has historically been a narrow exception to the general rule of expensing advertising costs as incurred.

³ FASB Accounting Standards Update No. 2010-26, *Accounting for Costs Associated With Acquiring or Renewing Insurance Contracts*.

Board members could not justify creating an industry exception to the decision made in the revenue recognition project in light of the complexities associated with advertising costs.

The Board's decision to eliminate the scope exception for direct-response advertising will bring an end to the legacy initially created under SOP 93-7. Upon issuance of a new insurance contracts standard, insurers who currently capitalize these costs will be required to expense them as incurred.

The Board clarified its decision not to allow an exception for direct-response advertising, confirming that no amendment to ASU 2010-26 was intended. The Board acknowledged that the current guidance will therefore remain effective until both the revenue recognition and insurance contracts projects are finalized.

Thinking Ahead

The FASB's unanimous decision to exclude direct-response advertising from acquisition costs will deny insurers the opportunity to capitalize and effectively spread such costs over the policy life. This decision, once finalized and effective as part of the insurance contracts project, will affect some insurers. The FASB expects to issue an exposure draft on the insurance project by the end of 2012. The final standard — and the resulting decision on direct-response advertising — is likely to be effective no earlier than January 1, 2016.

Insurance companies and entities that issue insurance contracts should continue to:

- Monitor the project's status and exchange views with others in the industry to better assess the ramifications of tentative Board decisions for their financial accounting and reporting processes.
- Actively participate in discussions with the FASB and the IASB and their staffs and in public forums to ensure that their voices are heard by the standard setters.
- Evaluate the ability of existing processes to capture the information needed for compliance and assess the impact on current business practices.

Watch for additional publications on the insurance contracts project as we continue to explore the practical and business implications of the decisions reached by the boards.

Other Deloitte Resources

- [June 2012, Insurance Accounting Newsletter \(Issue 25\), "Convergence on Insurance May Not Be Achieved Despite Progress in Recent Months."](#)
- [April 2012, Insurance Spotlight, "Intersection Ahead in the Revenue Recognition and Insurance Contracts Projects."](#)

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