Poly medica case study essay

Is advertising an asset or an expense? An asset is shown to be something that would give value to a company. An asset is usually referenced by a tangible item that could be sold. An expense is shown to be something that is an outflow of cash that would be referenced as an intangible item. Advertising has traditionally been listed as an expense. It is very difficult to show the tangibility of what advertising is worth.

PolyMedica’s reporting of direct response advertising as an asset and not expense raised issues with the Securities and Exchange Commission (SEC) because of the strict criteria needed to be put in place in order for a company’s advertising to be able to be counted as an asset according to revenue recognition guidelines. There is a fine line in the advertising world between what constitutes as reasonable cause for assuming that marketing dollars can regenerate future benefit outside of the period in which the advertising takes place.

The SEC rule on this is to provide sustainable evidence in that the direct response advertising has taken place. Such as matching the advertising dollars with the direct sales benefit of future sales contingent upon future values. For example if Polymedica can prove that the initial contact with the customer will generate future benefits through sales then the portion of the advertising can be written off through time. To be consider for this exclusion the company must be able to prove leads generated through the ads did provide future sales growth.

Polymedica did this by attaching a 1-800 number to the ads in order to track new customers acquired by the ad. Polymedica claims that a combination between generating this business through the direct response advertising along with sales follow ups after the initial order showed that customers whom used the 1-800 direct from the ad continued to do business with the company as a result. SEC’s and short sellers are concerned that the company is falsely attributing the ongoing benefits of the direct response advertising as it relates to future benefits after the period in which the expense has been incurred.

Polymedica needs to generate at what percentage do these customers sales depreciate over time from the direct response advertising in order to fully and accurately amortizable the asset on a proper time table and in order to comply with the exemption to revenue recognition. The capitalizing of these direct response advertisements will allow Polymedica to increase shareholder wealth by the deprecation of the expense over a four year period. It also allows the ompany to spend more money each year on advertising in order to increase customer base while giving them a competitive advantage over companies that currently are not taking advantage of the exemption to the advertising rules under current SEC regulations. Expensing the total amount of advertising will allow for analyst to see exactly what is spending every year on advertising. One could assume that there could be less money tied up in trying to track these advertisements. For example the cost of assigning all the 1-800 numbers in order for it to be considered a measurable expense.

It would also allow the SEC and short sellers a clear picture on the actual worth of the company compared to its competitors. Since advertising is an intangible asset if the company were to be sold that amount spent could not provide any future benefits to the buyers and has no sellable value. For example a traditional asset like a machine can be given a tangible dollar amount and that amount it's worth should be directly reflected on the balance sheet. In going forward with this thinking it's this intangible value that is allowing short sellers to believe that the companies share are actually overvalued.

The SEC decided to intervene because shares traded through the stock market need to be accurately disclosed in order to protect consumer interest. Polymedica's financial statements could be substantially impacted if the SEC would to deny the capitalization of the advertising. Exhibit A illustrates a comparison between balance statements that show advertising as an expense and as an asset. When advertising is shown as an expense instead of an asset there is a substantial decrease in assets.

For the balance sheet to balance there must be a decrease in shareholder equity in order to compensate for the decrease in assets. Exhibit B illustrates a comparison between income statements that show advertising as an expense and as an asset. The most notable difference is that instead of Polymedica turning a profit for fiscal years 2002 and 2003 Polymedica would be reporting a loss. A comparison of cash flow statements was not conducted since there is no actual change in the cash flow just a change on how it would be reported in the cash flow statement.

Recommendations: Polymedica should be collecting data from their direct response advertising in order to more accurately use marketing dollars. Analyzing which 1-800 are being called the most in order to insure that the money spent on the the target demographics. This report may also generate a rate of diminishing return on the advertising and going forward the company should look at how to best spend that money by reducing waste and spending less on the under preforming ad spots.

Once people are in general familiar with Polymedica there should be a decrease in advertising dollars getting the amount closer to realized amount. The company needs to accurately get a percentage of continued sales from the initial 1-800 number to most closely represent its depreciation. Also going forward the company needs to make sure that they put some money into a lobbying company to ensure the vested interested into direct response advertising can still be recognized as an asset. One of the jobs of a CEO of a company is to legally do everything possible to increase shareholder equity.

The point of a shareholder is to make money. If a company is not making money it will not be able to sell stock to create more capital needed for growth. As a CEO the option to capitalize the advertisement gives him the ability to increase shareholder equity which in turn shows stability. Without the SEC approval of this accounting measure Polymedica would be forced to expense the advertising. This could lead to a huge hit in stock prices and cause the company financial struggles in the future.