# Polymedica case solution essay

An expense is normally incurred by a firm to generate sales, e. g. promotional expenses which are selling expenses which are directly related to the generation of sales.

Most of the expenses normally form a part of operating expenses and are included in ' cost of sales'. It may either be raw materials, labor, etc. , or capitalized assets which are either depreciated or amortized over a period of time. These are known as matching costs. The other types of costs are ' period costs' which are mostly mentioned under S, G and A expense.

There are something known as the ' inventoriable costs' which are normally not shown immediately in the income statement. On the other hand, assets are classified under fixed and current assets, which are mostly part of the balance sheet. Any selling or buying of assets is shown as part of ' cash from investing' activity. Assets are directly or indirectly related to the future revenue generation for the firm. PolyMedica focused on direct to customer strategy to increase its customer base. Thus it focused on direct response customer right from 1996 to reach a larger portion of Medicare eligible patients to market their products.

This specifically was a pretty successful campaign, as the company increased its Medicare eligible diabetes customer base from 17, 000 to 545, 000 in 2003. To qualify as capitalized expenditure as assets, the direct responses expenses had to prove that the specific advertisements generated sales. Leads normally did not qualify. It has to be narrowly targeted and the response needs to be tracked.

The company ran various advertising commercials on the television with each commercial being given a separate toll free number. For each customer, the firm kept a track of prescription, doctor and insurance carrier. All customer names were maintained and separate coded order forms were kept track of. Calls made to the customers, insurance carriers and doctors were written off as administrative expenses which would generally fall under SGA expenses.

This indicated that the initial expenses (direct response advertising campaigns) were expenses which need to be capitalized as they generate the continuous stream of revenues. What would go against this argument would be that the second string of marketing activities of calling up the customers, insurance carriers and doctors are the activities which actually generate the stream of revenues. Without these activities, the initial direct response advertising is not sufficient to generate future sales, which is a typical characteristic of an asset. Thus, the direct response advertising is a period cost and need to be expensed. As the CEO of the given firm, I would capitalize the given expenses as they are definitely something which would help in the future generation of sales. Even fixed assets are something which normally require secondary marketing activities.

If the costs were expensed, gross margin would go down, as a result of which the operating income would also go down. The EBIT would remain unchanged though. Total assets would go down in 02 and 03 as net direct response advertising would be taken off and shown in the profit and loss account. The questions raised by short sellers and the department of justice would be answered by me as the CEO of the firm explaining the nature of the

costs. Any asset, as per definition is an item which is utilized to generate future streams of income.

It may directly or indirectly help in generating the future income streams (benefits). As per me, some assets also require some secondary marketing activities to derive future benefits. These direct response advertising costs were taken as a onetime cost and need to be capitalized. Each commercial had a separate toll free number to track the customers' response whose names were updated and separate coded customer forms were maintained.

To capitalize such expenses, it needs to be narrowly targeted, which in this case, it was as it was only targeted towards customers who were Medicare eligible diabetes patients.