Game Changer I: FASB/MASB Partnership for Aligning GAAP & MMAP

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Columbia University
Founding Director of MASB
August 2010
Boston

MASB
Marketing Accountability Standards Board
of the Marketing Accountability Foundation

The Next 3-Years (Game Changers)

Overall Objectives: Change the Game, Begin the Transformation

- **GC I: FASB/MASB Partnership for Aligning GAAP and MMAP**

  Become FASB's partner for changing the accounting & reporting rules related to marketing expenditures such that financial returns from corporations will be driven and measured by buyer behavior in markets over time*

* Buyers might be consumers, customers, investors, etc.

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Issue

Current financial accounting and reporting standards generally require marketing expenditures to be accounted for (written off) in the business period in which they are spent, despite evidence that "investments" in some activities, such as Branding and building customer equity, provide positive returns over a longer period of time and therefore have at least the potential for treatment as capital expenditures.

Without changes in current accounting and reporting rules, marketing activities will continue to be considered and managed as discretionary expenditures, not as strategic investment that adds long term value to the firm.

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Expected Results

Forming the MASB/FASB partnership to change the rules from "expense when incurred" to "capitalize over time of return" will:

1) Require Corporations to adopt and apply marketing measurement and accountability standards consistently and comprehensively to achieve a discipline and rigor similar to other applications of capital budgeting

2) Create value for all (better reporting/transparency through quantification of "good will", increase in Marketing ROI, predictable & consistent organic growth, improvement in corporate profitability and more and better products and services at less cost to meet the needs of society)

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FASB/MASB Partnership Project Team

Leads: Joe Plummer (Columbia)
David Reibstein (Wharton)
Accounting Educator (TBD)

Other: Russ Winer (Stern)
David Stewart (UCR)
Jim Gregory (CoreBrand)
2-3 Marketers (TBD)
Other (TBD)

Admin: Meg Blair (MAF/MASB)

Meetings: TBD

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Action Plan for FASB/MASB Partnership

I. Frame-Up Project, open debate /approval by MASB Directors (April –May 2010)*

II. Form Exploratory Team (June - August)

Leads: Reibstein & Plummer, Accounting

III. Lesson from FASB as to how the rules are changed (August)

IV. Approach FAF/FASB academics (August – September)

V. Document What is Known (September)

IV. Expand Team to Partnership Team Based on Feedback (August – October)

3-4 Major Marketers and 1-2 FAF/FASB educators

V. Approach FASB based on Feedback (October – December)

Recommend Partnership with rough draft of agreement and objectives

VI. Partnership Agreement & 1st Project Designated* (Jan - March 2011)

VII. Reporting rules changed for at least one category (March 2013)

* Explicitly approved by majority of MASB Directors & Chair

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Sue Bielstein

FASB Director of Planning and Support

- Responsible for planning & process matters, budgets, and special projects
- Leadership of the FASB's understandability initiative & oversight of process changes such as those recommended by
  - SEC Advisory Committee on Improving Financial Reporting
  - Financial Accounting Foundation Board of Trustees
- Was director of major projects & technical activities leading some of the most significant projects in FASB's history including
  - share-based payment
  - defined benefit pension & other postretirement plans
  - fair value measurement

THE FASB AND ACCOUNTING STANDARDS-SETTING

Sue Bielstein, FASB Director of Planning and Support

The views expressed represent those of the presenter. Official positions of the FASB are reached only after extensive due process and deliberations.

Presentation to the MASB: August 2010

US Financial Reporting Infrastructure

Public Sector Entities

Federal Government and its Agencies

- FASAB Standards (Federal Accounting Standards Advisory Board)
- FASB standards (some entities)

State and Local Governments

- GASB Standards

Private Sector Entities

SEC Registrants

US Companies:
- SEC Rules/Interpretive Releases
- FASB Standards

Foreign Private Issuers
- IFRS
- Other national GAAP, reconciled to US GAAP

Private Entities
- For profit companies
- NFP Organizations

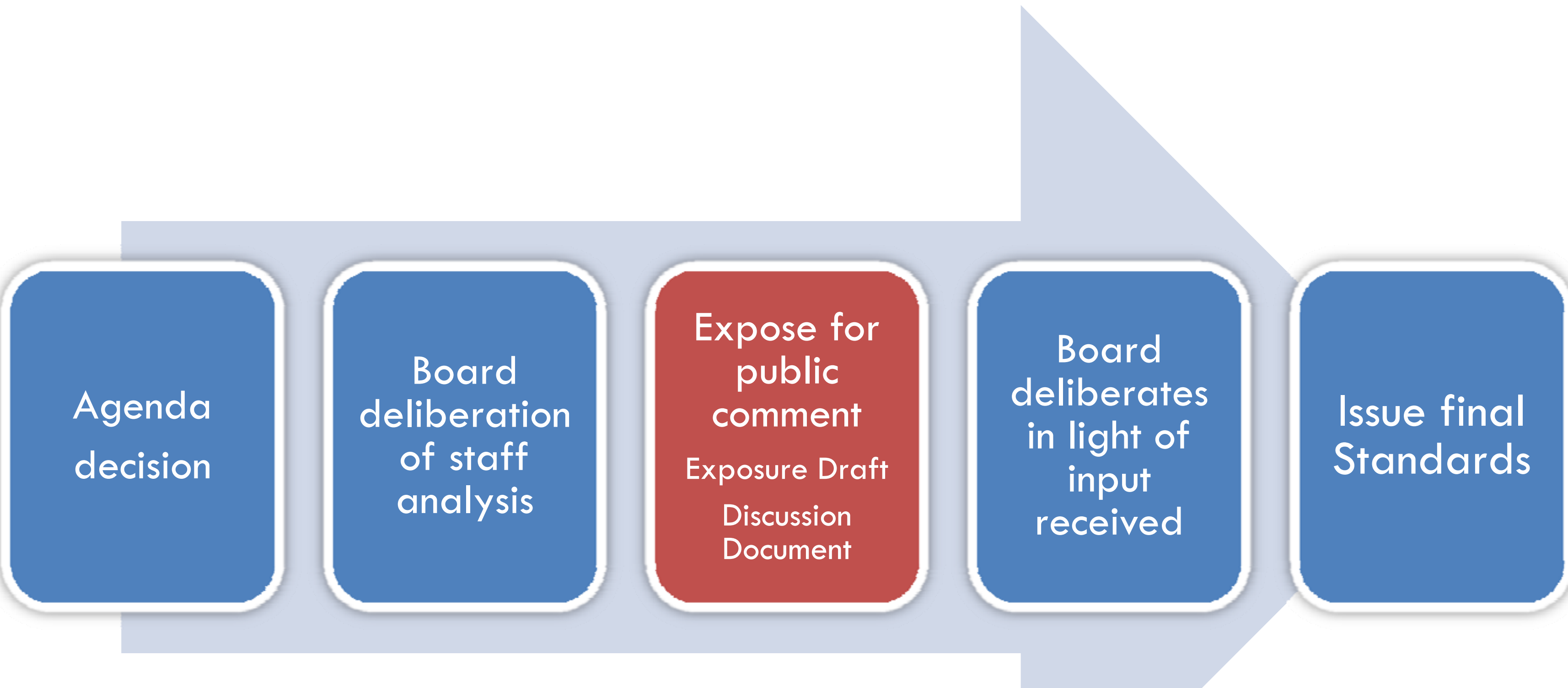
- FASB Standards
- Other comprehensive basis (e.g., modified cash basis, tax basis, statutory accounting principles)
- IFRS
- IFRS for small and medium sized entities

Elements of US Financial Reporting

- Financial statements
  - FASB and SEC-issued standards determine form and content
- Annual report
  - Financial statements
  - Other information such as letters from management, MD&A, various voluntarily provided metrics, both financial and non-financial
- SEC-required filings (10K, 10Q, 8K, and so forth)
  - Financial statements
  - Other information as required by various SEC rules, such as management's discussion and analysis, information about the company, risk disclosures, etc.

Observation: Financial statements are only one type of information reported to shareholders and other users. There inherent limits on the type of information that can be reported in financial statements. Many believe financial statements cannot effectively capture the value drivers of a business; they strongly advocate the development and reporting of nonfinancial metrics (e.g., market share, products sold less than two years old, quality measures)

Standards-Setting: High Level Overview



The process is designed to gather information from start to finish, and thereafter . . .

Agenda Decisions

Agenda decisions are essentially resource allocation decisions. There are many, many worthwhile financial reporting improvement opportunities. The following factors are used to evaluate each potential project and weigh the relative merits of the various different proposals.

- Pervasiveness of the issue (how significant is it from a user, preparer, or auditor perspective?)
- Alternative solutions (are there alternative ways of meeting the information need?)
- Technical feasibility (how likely is it that we can develop an improved financial statement solution? Are there other projects that should be completed first?)
- Practical consequences
- Convergence opportunities (is this an opportunity to eliminate differences with IFRS, improve reporting internationally?)
- Resources (do the Board and staff have adequate time and resources to address the issue?)

Agenda Proposals

Anyone can submit an agenda proposal to the FASB for consideration. In doing so, they should explain:

- The nature of the issue and why they think the Board should take on a project to address it (how pervasive is it)
- How financial reporting should be changed to improve reporting (including conceptual and practical issues)
- Convergence considerations (whether this is an issue that should be address globally or in a US-reporting context only)
- Given the FASB's emphasis on the information needs of users, any available information about the importance of the issue to users and the value of the proposed reporting solution to users.

General Operating Matters

- Accounting standards are a judgment; those judgments are made exclusively by the 5-member FASB after extensive consultation and deliberation. A majority of the 5-member Board must approve a new standard.
- The FASB can, and sometimes will, commission other organizations to undertake research work on selected issues.
- The FASB encourages and welcomes research work undertaken voluntarily by others.
  - Financial Accounting Standards Research Initiative (FASRI)
  - National Standards Setters of other countries

Intangible Assets Accounting – Some Recent History

- 1990s -- “New Economy”
  - Some criticized the accounting model as “outdated”
  - Fails to capture the most important assets of a business, the real “value-drivers”
  - (The significant difference between market caps and book values must be explained by these valuable and unreported assets)
  - Some advocated the required reporting of “KPIs” instead of traditional accounting measures
- Intangible asset initiatives
  - Business Combination Accounting (accounting for the purchase of one company by another)—some improved transparency
  - FASB Project to Improve Disclosures about Intangible Assets—initiative abandoned
  - 2007 intangible asset agenda proposal submitted by AASB—project not added, but research project encouraged
- Intangible asset accounting – why change is hard
  - Companies argue that it is very hard to reliably measure intangible assets and its expensive to do so (need to hire valuation experts)
  - Lack of sufficiently broad-based Investor interest/support
  - Cost-based information isn’t relevant, value information is feared (another step on the road to a fair value balance sheet)
  - More important to fix other aspects of financial reporting (off-balance sheet reporting, financial instrument accounting)

For MASB Consideration

What are the various ways of communicating marketing information, and how do they compare in terms of effectiveness, practicality, and cost?

- “Conventional” accounting methods (do marketing efforts create assets that should be reported on balance sheets)
- Disclosures in notes to financial statements (are existing disclosure as robust/informative/effective as possible?)
- Financial or Non-financial performance metrics (would the results of marketing efforts be better captured and monitored using KPIs? Could MASB develop standards for measuring those KPIs?)
- Qualitative/descriptive disclosures outside financial statements (should the SEC require enhanced disclosures in company information, MD&A, or in other ways?)

Questions and Answers

Break-Out (Groups A & B)

Assume branding activities are considered capital investment and expensed/amortized over time…say brand advertising is expensed over 3 Years

How will this change the game?

+/- and why?

	A	B
Finance	Kampsen	Matthews
Marketing	Liodice	Lewis
Leader	Reibstein	Winer
Recorder	Kuse	Farris

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Report Group A

General Comments/Questions
Negatives for one constituency will be positives for another and vice versa

Negatives
Tax implications - transition costs in first 3 years
Management uncertainty regarding benefit
Investor concern about management manipulation
Less flexibility for CFOs
Could encourage padding of budgets

Positives
More flexibility for management
Will reduce need for cutting marketing spending
Use to justify marketing spend to management
Repositions marketing as long-term investment
Changes equity base on financial statements
Creates need to reconcile expenses to benefits (return)
Brings focus on brand building advertising

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Report Group B

General Comments/Questions
Advertising applies only to a few industries.
Direct response media investments are amortized, but limit is 12 months.
Sufficient evidence for direct response campaigns allows for amortization over the expected sales production horizon.
Website and software development for internal use are expensed, for external sales they are amortized.

Negatives
Might stabilized spending by reducing incentive to cut advertising in short term..i.e. profits would not benefit from short-term cuts as much as when all expensed.

Positives
Amortizing over multiple years would encourage investment in marketing programs with longer payouts
Can amortize production cost over planned media schedule

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Thank-you!