FASB and IASB Accounting Treatment Comparison

Posted on May 4, 2020

To: Management and the Finance Committee

From: Accounting Adviser

Subject: Comparison of FASB and IASB Accounting Treatments for Selected Transactions

This memorandum evaluates the accounting treatment of prepaid insurance, research and development, advertising, employee injury claims, sale-and-leaseback arrangements, voluntary redundancies, customer advances, and litigation involving faulty software. The original memorandum correctly recognizes several basic principles: insurance paid in advance is initially an asset, customer deposits are liabilities until performance occurs, and probable measurable obligations may require accrual. It also contains oversimplifications. Research and development are not treated identically under U.S. GAAP and IFRS, a legal claim is not recorded merely because it exists, and a transfer followed by a leaseback is not automatically accounted for as a simple sale.

The analysis should begin by identifying the reporting framework. The Financial Accounting Standards Board establishes U.S. generally accepted accounting principles through the Accounting Standards Codification. The International Accounting Standards Board issues IFRS Accounting Standards. The two frameworks often produce similar outcomes but differ in terminology, recognition thresholds, development costs, contingencies, leases, and presentation. Journal entries below are illustrative; actual account names and amounts depend on contracts, dates, materiality, and professional judgment. (“Financial Accounting Standards Board”, 2026)

1. Prepaid Insurance

When a company pays an insurance premium covering future periods, it receives a right to insurance protection rather than consuming the entire benefit immediately. The unexpired portion is recognized as a prepaid asset under both U.S. GAAP and IFRS. Classification as current or noncurrent depends on when the benefit will be consumed. Most annual policies are current assets.

At payment:

Debit: Prepaid insurance
Credit: Cash or bank

As coverage is consumed:

Debit: Insurance expense
Credit: Prepaid insurance

The original memorandum is therefore correct that advance insurance should remain on the statement of financial position until the coverage period passes. The company should use a monthly or otherwise systematic allocation that reflects the policy period. If insurance was prepaid for several years, the portion expected to be consumed after twelve months may be noncurrent.

2. Research Expenditure

The original response treats all research and development as an immediate expense under IFRS. That is only partly correct. IAS 38 requires expenditure in the research phase to be expensed when incurred because the entity cannot yet demonstrate that an intangible asset capable of generating probable future economic benefits exists.

Typical research activities include investigating alternatives, exploring new knowledge, and evaluating possible designs before technical feasibility is established. The entry is:

Debit: Research expense
Credit: Cash, payables, payroll, or materials

U.S. GAAP also generally expenses research and development costs as incurred, subject to specific exceptions such as certain software-development costs, materials or equipment with alternative future uses, and accounting by entities in specialized arrangements. The general result for pure research is therefore similar under both frameworks.

3. Development Expenditure

Development is where IFRS and U.S. GAAP differ significantly. Under IAS 38, development expenditure must be capitalized after the entity demonstrates all required criteria: technical feasibility, intention and ability to complete and use or sell the asset, probable future economic benefits, adequate resources, and ability to measure costs reliably. Costs incurred before these criteria are met remain expenses and cannot later be reinstated as an asset.

Once capitalization begins:

Debit: Development intangible asset
Credit: Cash, payroll, or payables

After the asset is available for use, it is amortized over its useful life and tested for impairment according to applicable standards. U.S. GAAP generally expenses research and development as incurred, creating a difference from IFRS. Separate rules apply to software to be sold, leased, marketed, or used internally. The memorandum should therefore not label every development cost a one-period revenue expenditure without investigating the project stage and framework.

4. Advertising Expenditure

Advertising and promotional expenditure is generally recognized as an expense rather than an internally generated intangible asset. Under IFRS, IAS 38 requires expenditure on advertising and promotional activities to be expensed when the entity has access to the goods or receives the services. Prepayments remain assets until the advertising service occurs.

If an agency is paid before a campaign runs:

Debit: Prepaid advertising
Credit: Cash

When the campaign is delivered:

Debit: Advertising expense
Credit: Prepaid advertising

U.S. GAAP generally expenses advertising either as incurred or the first time the advertising occurs, depending on the accounting policy and the nature of the arrangement. Direct-response advertising had historically received specialized treatment, but ordinary image and product advertising is not capitalized merely because management expects future sales. The expected benefit is too uncertain to meet asset recognition requirements.

5. Going Concern

The original memorandum invokes the going-concern concept when discussing an injury claim. Going concern is important, but it is not the primary recognition principle for that claim. Going concern concerns whether the company is expected to continue operating and meet obligations rather than liquidate or cease trading in the foreseeable future. Management must assess material uncertainties and disclose them where required.

The fact that an employee has worked for the company for eight years does not establish going concern. Nor does a desire to prepare for future accidents. The injury claim should instead be analyzed under contingency or provision standards. Going concern becomes relevant only if the claim, combined with other conditions, threatens the company's ability to continue.

6. Employee Injury Claim

Assume an employee has suffered an injury and may claim 300,000. The company should not create a “contingent account” simply to set money aside. Accounting recognition depends on whether an obligation exists at the reporting date, the likelihood of an outflow, and whether the amount can be estimated.

Under IAS 37, a provision is recognized when the company has a present legal or constructive obligation from a past event, an outflow of resources is probable, and a reliable estimate can be made. The amount is the best estimate of the expenditure required to settle the obligation, discounted when the time value of money is material.

Under U.S. GAAP, a loss contingency is accrued when it is probable that a liability has been incurred and the amount can be reasonably estimated. The meaning and application of “probable” differ somewhat from IFRS, and measurement of a range can also differ.

If recognition criteria are met:

Debit: Injury or legal expense
Credit: Provision or accrued liability

If loss is only reasonably possible, disclosure may be required without recognition. If remote, neither recognition nor disclosure may be necessary, subject to exceptions. Legal counsel’s assessment is evidence but does not replace management’s accounting responsibility.

7. Measurement of the Injury Provision

The original response assumes the company should accrue exactly 300,000. That is appropriate only if 300,000 is the best estimate under the applicable standard. If possible outcomes range widely, management should evaluate probability and available evidence.

Under IFRS, a large population of similar obligations may be measured using expected value, while a single obligation may be measured at the most likely outcome adjusted for other possible outcomes. Under U.S. GAAP, if no amount within a range is a better estimate than another, the minimum amount in the range is generally accrued and the additional exposure disclosed.

The file should document the incident, claim status, insurance coverage, legal advice, comparable settlements, and assumptions. A reserve cannot be used to smooth earnings or create a general cushion for future accidents that have not occurred.

8. Sale and Leaseback of the Building

The original memorandum says the building transfer should be treated as a sale because ownership moved to the bank. Modern lease standards require a more careful analysis. The company must first determine whether the transfer qualifies as a sale under the relevant revenue-control principles. Legal title alone is not decisive if the seller retains control through contractual terms.

Under IFRS 16 and U.S. GAAP Topic 842, a qualifying sale followed by a leaseback produces recognition of the sale and a lease obligation, but the detailed measurement differs. The seller-lessee does not simply credit the entire building and later debit ordinary rent as though no continuing right exists.

If the transfer does not qualify as a sale, the company generally continues recognizing the building and records the proceeds as a financing liability:

Debit: Cash
Credit: Financing liability

Subsequent payments are allocated between interest and reduction of the financing liability.

9. IFRS Sale-and-Leaseback Treatment

If the transfer qualifies as a sale under IFRS 15, IFRS 16 requires the seller-lessee to recognize only the gain or loss relating to rights transferred to the buyer-lessor. The seller-lessee recognizes a right-of-use asset representing the retained right to use the building and a lease liability.

The transaction must also be evaluated for off-market terms. If the sale price or lease payments differ from fair value and market rates, adjustments may represent prepayment or additional financing. A repurchase option can prevent sale accounting depending on its terms.

The original proposed entry—debit bank and credit land and buildings—is therefore incomplete. It omits derecognition of accumulated depreciation, right-of-use asset, lease liability, gain or loss, and possible financing adjustment.

10. U.S. GAAP Sale-and-Leaseback Treatment

Under Topic 842, the seller-lessee applies the sale guidance in Topic 606 to determine whether control transferred. If a sale occurs, the seller generally derecognizes the asset, recognizes the transaction price, records a lease under Topic 842, and recognizes the resulting gain or loss according to applicable requirements.

Repurchase options, transfer restrictions, and the buyer-lessor's control are critical. A transaction structured legally as a sale may be financing in substance. Accounting should follow economic substance and the standards, not management's statement that the arrangement is or is not "a smart move."

11. Lease Payments

The original response treats all lease payments as immediate rent expense. Under modern lease accounting, most leases create a right-of-use asset and lease liability on the balance sheet, subject to short-term and low-value exemptions under IFRS and short-term elections under U.S. GAAP.

For an operating lease under U.S. GAAP, a single lease expense is generally recognized, while the balance-sheet amounts change over time. For a finance lease, interest and amortization are recognized separately. Under IFRS, lessees generally use a single on-balance-sheet model with depreciation of the right-of-use asset and interest on the liability, subject to exemptions.

Cash payment entries therefore depend on the classification and system. A simple debit to rent expense may be appropriate only for a qualifying exempt short-term arrangement or certain variable payments.

12. Repurchase of the Building

The original memorandum proposes recording land and buildings if the company buys the property back. The actual accounting depends on whether the original transfer was a sale, whether a repurchase option existed from the beginning, and the terms of the later acquisition.

If a substantive repurchase option meant control never transferred, the original transaction may have been financing rather than sale-and-leaseback. If the repurchase is a separate later transaction, the building is recognized at the appropriate acquisition cost and the existing lease or right-of-use asset is modified or terminated according to the agreement.

Management should not wait until repurchase to analyze the option. The option's existence at the original transaction date can determine the entire accounting model.

13. Voluntary Redundancies

The proposed employee redundancies raise questions under IAS 19, IAS 37, U.S. GAAP employee-termination guidance, and subsequent-event standards. A board discussion alone may not create a present obligation. Recognition depends on whether the company is demonstrably committed to a detailed plan and can no longer realistically withdraw the offer or termination decision. ("International

Accounting Standards Board”, 2026)

For voluntary termination benefits, liability recognition generally occurs when the employee accepts the offer or when the entity cannot withdraw it, depending on the framework and circumstances. The amount should be based on expected acceptances and benefit terms.

The original statement that the redundancy is automatically a post-balance-sheet event requiring an increased provision is too broad. If the obligating event occurred after the reporting date, it may be a non-adjusting event requiring disclosure if material. If conditions existed and the obligation arose before the reporting date, adjustment may be required.

14. Subsequent Events

Events after the reporting period are divided into adjusting and non-adjusting events. Adjusting events provide evidence of conditions existing at the reporting date. Non-adjusting events reflect conditions arising later. (“International Accounting Standards Board”, 2026)

A lawsuit settlement after year-end may confirm the amount of a liability that existed at year-end and therefore adjust the accounts. A new restructuring decision made after year-end may be non-adjusting but disclosed if material. The date of board approval, communication to employees, employee acceptance, and inability to withdraw the plan must be established.

15. Customer Advances for Software

The original memorandum correctly concludes that cash received with advance orders is not automatically revenue. Under IFRS 15 and ASC 606, revenue is recognized when or as the entity satisfies performance obligations by transferring promised goods or services to the customer. Before performance, consideration received is generally a contract liability.

At receipt:

Debit: Cash
Credit: Contract liability or customer advances

When the software license, product, implementation, support, or other promised performance is transferred according to the contract:

Debit: Contract liability
Credit: Revenue

The company must identify distinct performance obligations. A software arrangement may include a license, updates, hosting, installation, training, and support. Revenue timing may differ for each component.

16. Right of Return, Cancellation, and Refund Terms

Customer advances require analysis of cancellation rights and refundability. If the customer can demand repayment, classification and measurement may differ from a nonrefundable advance. The company must consider whether a significant financing component exists when payment and performance are separated by a long period.

Tax consequences, foreign currency, and sales commissions may also require separate accounting. The original entry using the customer's name as an account can work in a simple ledger, but a controlled contract-liability subledger is preferable.

17. Faulty-Software Litigation

The original memorandum says the company must record a provision despite the lawyer's advice. That conclusion is not justified without knowing the lawyer's assessment and other evidence. Legal advice is central to evaluating whether a present obligation exists, whether loss is probable, and whether it can be estimated.

If recognition criteria are met, the company accrues the best estimate. If the loss is possible but not probable, it may disclose the nature and potential financial effect. If disclosure would seriously prejudice the company's position, limited exceptions may apply under IFRS, but the general nature of the dispute may still need disclosure.

If the claim is remote, no accrual is recorded. A company should not deliberately overstate liabilities to appear conservative; neutrality and faithful representation are required.

18. Difference Between a Provision and a Contingent Liability

Under IFRS terminology, a provision is recognized because a present obligation and probable outflow exist and the amount can be estimated reliably. A contingent liability is generally not recognized because the obligation is possible, or because outflow is not probable or cannot be measured reliably. It is disclosed unless the possibility of outflow is remote.

U.S. GAAP uses the term loss contingency and applies its own probability framework. Because language differs, management should not assume the same word has exactly the same recognition threshold under both systems.

19. Materiality and Documentation

Every conclusion should consider materiality. A small prepaid item may be expensed immediately if the effect is immaterial and policy is consistent, while a material multi-year insurance payment requires deferral. Materiality is entity-specific and includes qualitative as well as quantitative factors.

Documentation should identify the transaction, governing standard, facts, alternatives, judgment, calculation, entry, disclosure, and approval. Legal contracts should be reviewed rather than summarized informally.

20. Summary of Major IFRS–U.S. GAAP Differences

Both frameworks generally capitalize prepaid insurance and recognize customer advances as liabilities until performance. Both generally expense research and ordinary advertising. IFRS capitalizes qualifying development costs, while U.S. GAAP usually expenses research and development except under specialized guidance. Provision and loss-contingency thresholds and measurement can differ. Lease presentation and sale-and-leaseback details also differ, though both frameworks place most leases on the balance sheet.

These differences can affect profit timing, asset balances, ratios, covenants, and comparability. A company reporting under both systems may need reconciliation rather than one universal entry.

Conclusion

The original accounting judgments are partly correct but require framework-specific analysis. Prepaid insurance is an asset until coverage is consumed. Research is expensed under both systems, while qualifying development expenditure is capitalized under IFRS but usually expensed under U.S. GAAP. Ordinary advertising is generally expensed when received or first used, with prepayments deferred until service.

Employee injury and software litigation require probability, obligation, and measurement analysis; they are not accrued automatically. A sale-and-leaseback depends on transfer of control and creates lease accounting consequences rather than a simple sale plus rent. Voluntary redundancies are recognized only when the applicable obligation criteria are met. Customer advances remain contract liabilities until the promised software goods or services transfer.

Management should apply current authoritative standards, obtain legal and valuation evidence, and document judgments. Conservatism does not mean recording every possible loss. Faithful accounting recognizes assets, liabilities, income, and expenses when the relevant definitions and recognition criteria are satisfied. (“International Accounting Standards Board”, 2026)

References

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