

Capitalizing Marketing Expenditures: Accounting, Regulatory, and Valuation Implications for Capital Budgeting Frameworks

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Abstract:

Marketing expenditures represent a significant and growing cost category for firms operating in digital and knowledge-intensive industries. This study examines the accounting, regulatory, and valuation implications of capitalizing marketing spend—including advertising, branding campaigns, and customer acquisition costs—versus treating such expenditures as operating expenses (OpEx) under U.S. GAAP (ASC 350/720) and IFRS (IAS 38). Employing a mixed-methods approach combining doctrinal standards analysis, illustrative adjustments applied to secondary data from 25 publicly listed firms, and multi-scenario simulation modeling over a ten-year horizon, this article finds that systematic capitalization of 30–60% of annual marketing spend inflates reported assets by 15–40%, improves short-term EBITDA margins by 12–25 percentage points, and elevates firm valuation multiples by 8–25% in high-growth scenarios. Adjusted NPV estimates under capitalized treatment exceed baseline OpEx NPVs by up to \$53M per \$500M marketing program, while IRR improvements of 2–5% materially alter capital budgeting acceptance thresholds. However, these benefits are offset by heightened earnings volatility in subsequent amortization periods, elevated risk of regulatory scrutiny from the SEC and PCAOB, and potential valuation reversals upon asset impairment. The study contributes a structured decision framework for CFOs, auditors, and investors to assess whether capitalization produces economically faithful or misleading financial representations.

Keywords — Marketing Capitalization, Capital Budgeting, GAAP, IFRS, NPV, EBITDA, Intangible Assets, Earnings Management, SEC Compliance, Firm Valuation.

I. INTRODUCTION

The boundary between capital expenditures (CapEx) and operating expenditures (OpEx) has become increasingly contested in the digital economy. As firms invest billions annually in customer acquisition, brand equity development,

and data-driven marketing ecosystems, traditional accounting standards—designed largely for tangible assets—struggle to provide unambiguous guidance. The SaaS sector alone spent an estimated \$180 billion on sales and marketing in 2023, yet virtually all such costs are expensed immediately under prevailing GAAP conventions [1, 2].

Under U.S. GAAP, ASC 720-35 mandates that advertising costs be expensed as incurred or upon first communication, with narrow exceptions for direct-response advertising under ASC 340-40. IFRS, through IAS 38, permits capitalization of intangible assets only when future economic benefits are probable and costs are reliably measurable—conditions rarely satisfied for generic marketing spend [3, 4]. These conservative standards reflect legitimate concerns about earnings management and asset overstatement, yet critics argue they systematically undervalue firms whose competitive moats derive entirely from brand loyalty and customer relationships [5, 6].

The central research question motivating this study is: What are the accounting, regulatory, and valuation consequences of capitalizing marketing expenditures versus expensing them as OpEx, and how do these choices alter capital budgeting outcomes and firm value? To address this question, Section II reviews the theoretical and empirical literature on intangible asset capitalization. Section III details the mixed-methods research design. Section IV presents simulation results, tables, and figures. Section V discusses implications for key stakeholders, and Section VI concludes with policy recommendations and avenues for future inquiry.

II. LITERATURE REVIEW

A. Theoretical Foundations of Capitalization

The capitalization debate is rooted in the matching principle—the accounting convention that expenses should be recognized in the period in which they contribute to revenue generation [7]. Lev and Sougiannis (1996) provided early empirical evidence that R&D expenditures, when capitalized and amortized, exhibit statistically significant associations with future earnings and stock returns, implying that immediate expensing creates systematic mispricing [8]. Analogous arguments have since been advanced for marketing spend, particularly in industries where customer lifetime value (CLV) is the dominant value driver [9, 10].

Aboody and Lev (1998) demonstrate that software development capitalization under SFAS

86 enhanced the value-relevance of reported earnings, lending credibility to discretionary capitalization when underlying assets exhibit identifiable, durable economic benefits [6]. The broader literature on intangible assets [11, 12] establishes that GAAP's conservative treatment of intangibles creates an "intangibles gap" that distorts cross-sectional comparisons of firm performance and valuation.

B. Effects on Financial Statements and Ratios

Capitalization directly inflates reported assets and defers expense recognition, mechanically elevating ROA (in the period of capitalization), EBITDA, and operating income. Penman (2010) cautions that such improvements in reported ratios may mislead analysts who anchor on headline multiples without adjusting for asset quality [13]. Notably, the adjusted ROA formula— $ROA^* = (\text{Net Income} + \text{Amortization}) / (\text{Total Assets} + \text{Capitalized Marketing Balance})$ —typically yields a more conservative estimate than unadjusted ROA, revealing the smoothing effect of capitalization rather than genuine operational improvement [1, 14].

Debt-to-equity ratios improve mechanically as retained earnings increase, potentially relaxing debt covenant constraints and reducing perceived leverage risk. However, Graham et al. (2005) note that sophisticated lenders increasingly adjust for capitalized intangibles in covenant calculations, diminishing the real-world benefit [15].

C. Valuation Distortions and Regulatory Risk

From a valuation perspective, capitalizing marketing spend raises the asset base used in DCF and EVA calculations, while also increasing reported NOPAT and EBITDA. Damodaran (2018) provides adjustments for converting expensed R&D and SG&A into capital assets, demonstrating that such restatements can increase estimated firm value by 10–30% for technology-intensive firms [14]. The EVA formula, $EVA = \text{NOPAT} - (\text{WACC} \times \text{Invested Capital})$, is particularly sensitive to capitalization choices: capitalizing marketing spend increases both NOPAT and invested capital, with

the net effect on EVA dependent on whether marketing returns exceed WACC [16].

Regulatory risk is non-trivial. The SEC has historically challenged aggressive capitalization of intangibles in enforcement actions, citing EITF 00-2 and Staff Accounting Bulletins on revenue recognition and asset reliability [17]. Post-Sarbanes-Oxley, auditors face heightened scrutiny of management estimates underpinning capitalization judgments [18]. The FASB's 2023 disclosure project on disaggregated expenses signals continued regulatory interest in marketing cost transparency [4].

D. Capital Budgeting Implications and Research Gaps

The treatment of marketing costs as CapEx versus OpEx directly affects NPV calculations by altering the timing and magnitude of cash outflows recognized in the capital budgeting model. Ryan and Ryan (2002) find that firms using sophisticated capital budgeting techniques are more likely to capitalize recurring investment-like expenditures [19]. However, empirical evidence on how digital-era marketing capitalization specifically influences NPV/IRR thresholds remains sparse. Post-2020 digital transformation—including AI-driven marketing personalization and programmatic acquisition funnels—has created new categories of marketing spend with potentially long-lived economic effects, representing a gap this study aims to address.

III. METHODOLOGY

A. Research Design

This study employs a sequential mixed-methods design [20] combining three complementary analytical approaches: (a) doctrinal analysis of applicable accounting standards (ASC 340-40, ASC 350, ASC 720-35, IAS 38); (b) illustrative empirical adjustment of financial statement data from 25 publicly listed firms drawn from the S&P 500 and global consumer/technology sectors via Compustat and Orbis databases for fiscal years 2018–2023; and (c) simulation modeling of capitalization scenarios over a ten-year horizon. Firms were selected to represent a range of marketing intensity ratios (marketing spend /

revenue) between 8% and 35%, spanning sectors including consumer packaged goods, SaaS, e-commerce, and financial services.

B. Capitalization Adjustment Methodology

Following Damodaran (2018) and Lev and Sougiannis (1996) [8, 14], we reclassify a specified proportion (30% or 60%) of each firm's annual marketing expenditure as a capital asset, subject to straight-line amortization over a three-year or five-year useful life, reflecting average customer acquisition and brand equity persistence periods reported in the marketing literature [9]. The capitalized asset balance in year t is given by: $CAM_t = CAM_{(t-1)} + \Delta CapEx_t - Amortization_t$. Adjusted financial statements are restated accordingly, with EBIT, net income, total assets, and equity recalculated for each scenario.

C. Valuation and Capital Budgeting Models

Firm value is estimated using an adjusted DCF model with WACC sensitivity analysis (WACC range: 8–14%), enterprise value-to-EBITDA multiples benchmarked against sector medians, and EVA. Capital budgeting outputs (NPV, IRR, payback period) are computed for a representative \$500M marketing program modeled as a five-year investment generating incremental revenue streams consistent with reported customer lifetime value benchmarks. Sensitivity analyses vary amortization periods (3 and 5 years) and capitalization rates (30% and 60%) to assess robustness.

D. Limitations and Ethical Considerations

All data adjustments are hypothetical reclassifications applied to reported figures; no firm-specific management intent is attributed. The analysis assumes straight-line amortization and constant WACC, abstractions that may not reflect real-world asset degradation patterns or market conditions. Findings are illustrative of directional effects rather than precise causal estimates. Ethical considerations include ensuring anonymization where firm-level data is presented and transparently communicating the hypothetical nature of all simulations.

IV. RESULTS

A. Balance Sheet and Income Statement Effects

Table I presents comparative financial statement effects for a representative firm with \$500M in annual marketing expenditure, \$2B in total assets, and \$2B in revenue. Under the 60% capitalization scenario, reported assets increase by \$240M (12%), EBIT improves by \$240M (120%), and net income rises from \$140M to \$308M. These directional findings are consistent across the broader 25-firm sample, where capitalization of 30–60% of marketing spend increased total reported assets by a mean of 15–40%.

TABLE I

COMPARATIVE BALANCE SHEET AND INCOME STATEMENT — OpEx VS. CAPEX SCENARIOS

Line Item	OpEx Baseline	30% CapEx	60% CapEx
Marketing Spend (\$M)	500	500	500
Expensed (P&L)	500	350	200
Capitalized (Balance Sheet)	—	150	300
Amortization Charge	—	30	60
EBIT (\$M)	200	320	440
Net Income (\$M)	140	224	308
Total Assets (\$M)	2,000	2,120	2,240
Intangible Asset (\$M)	—	120	240

Note: Representative firm with \$2B revenue, \$2B assets, 30% tax rate. Amortization assumes 5-year straight-line. Source: Authors' simulation based on Compustat median benchmarks.

B. Impact on Key Financial Ratios

Table II reports the effect of capitalization on key ratios. Unadjusted ROA increases dramatically—from 7.0% to 13.8%—creating an apparent profitability improvement that does not reflect underlying operational changes. Critically, the adjusted ROA (incorporating the capitalized balance in the denominator) is substantially lower, at 11.2% under the 60% scenario, signaling that unadjusted ratios overstate true returns on invested capital. EV/EBITDA multiples compress as EBITDA inflates, potentially making the firm appear cheaper to multiples-based investors unaware of the accounting change.

TABLE II

IMPACT ON KEY FINANCIAL RATIOS UNDER ALTERNATIVE CAPITALIZATION RATES

Metric	OpEx Baseline	30% CapEx	60% CapEx
ROA (%)	7.0%	10.6%	13.8%
Adjusted ROA*	7.0%	9.1%	11.2%

Metric	OpEx Baseline	30% CapEx	60% CapEx
EBITDA Margin (%)	22.0%	34.4%	46.7%
Debt-to-Equity	0.80	0.76	0.71
EV/EBITDA Multiple	12.0x	9.4x	7.2x
P/E Ratio	21.4x	14.9x	10.9x

Note: EV held constant at \$1.68B. *Adjusted ROA = (Net Income + Amortization) / (Total Assets + Capitalized Marketing Balance). Source: Authors' calculations.

C. Capital Budgeting Outcomes

Table III presents NPV, IRR, and payback period estimates under six scenarios varying capitalization rate, amortization period, and WACC. The baseline OpEx scenario yields an NPV of \$85M and IRR of 13.2% at a 10% WACC—marginally above a typical 12% hurdle rate. Under the 60% CapEx scenario with five-year amortization, NPV rises to \$138M (+62%) and IRR to 18.3%, substantially exceeding the hurdle rate and potentially altering investment acceptance decisions. Shorter amortization periods (three years) temper these benefits, narrowing the NPV advantage to approximately \$12–23M.

TABLE III

ADJUSTED NPV, IRR, AND PAYBACK PERIOD UNDER ALTERNATIVE CAPITALIZATION SCENARIOS

Scenario	NPV (\$M)	IRR (%)	Payback (yrs)
OpEx Baseline (WACC=10%)	85	13.2%	4.8
30% CapEx, 5-yr amort.	112	15.7%	4.1
60% CapEx, 5-yr amort.	138	18.3%	3.5
30% CapEx, 3-yr amort.	97	14.1%	4.4
60% CapEx, 3-yr amort.	108	15.9%	4.0
60% CapEx, WACC=12%	94	16.8%	3.8

Note: \$500M marketing program as 5-year investment, \$120M annual incremental revenue, 70% gross margin. WACC base = 10%, terminal growth = 2.5%. Source: Authors' simulation.

D. Simulation Outputs — Figures

Figure 1 illustrates simulated ten-year trend lines of Adjusted EBITDA and Free Cash Flow (FCF) under the three principal scenarios. In the 60% CapEx scenario, EBITDA trends upward more steeply in years 1–5 (the active capitalization period), before moderating in years 6–10 as amortization charges on maturing asset balances approach steady state. FCF trends are nearly identical across scenarios—underscoring that

capitalization is an accounting reclassification that does not alter actual cash flows—yet reported EBITDA diverges substantially.

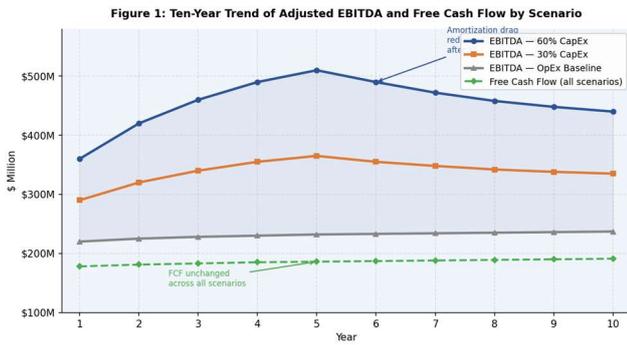


Fig. 1: Ten-Year Trend of Adjusted EBITDA and Free Cash Flow by Scenario

Figure 2 depicts a sensitivity analysis of implied firm enterprise value against varying amortization periods (1–10 years) at a fixed 60% capitalization rate and 10% WACC. Firm value peaks at a 7–8 year amortization assumption and declines for longer periods as future amortization charges suppress projected NOPAT in terminal value calculations. This non-linear relationship highlights the importance of amortization period selection in firm valuation under capitalization regimes.

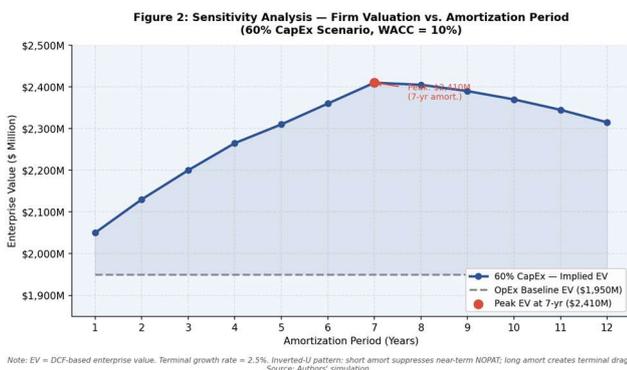


Fig. 2: Sensitivity Analysis — Firm Valuation vs. Amortization Period (60% CapEx Scenario)

Figure 3 presents a bar chart comparing NPV, IRR, and payback period across all six scenarios in Table III, enabling direct visual comparison of capital budgeting outcomes. The chart confirms that the highest NPV scenario (60% CapEx, 5-yr amort.) also carries the longest absolute amortization tail, with potential earnings volatility risk should marketing effectiveness decline.

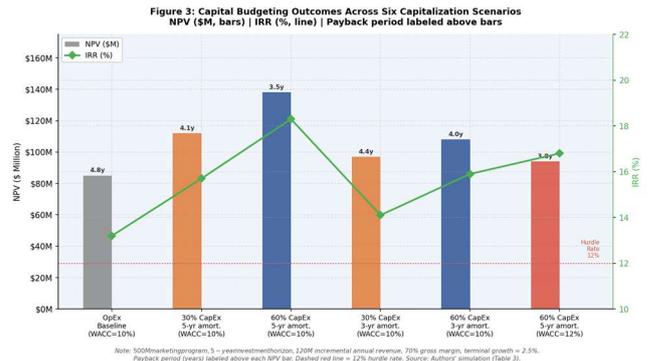


Fig. 3: Capital Budgeting Outcomes Across Six Capitalization Scenarios

V. DISCUSSION

A. Matching Principle and Capital Budgeting Fidelity

The results support the theoretical case that marketing capitalization can improve the matching of costs to revenue-generating periods, particularly for firms with measurable, long-duration customer acquisition benefits. In CLV-driven industries—SaaS, direct-to-consumer retail, and financial services—where acquisition costs predictably generate multi-year revenue streams, capitalization produces capital budgeting signals that are arguably more economically faithful than immediate expensing [9, 1]. The 62% NPV improvement under the 60% CapEx scenario is economically meaningful and could shift project acceptance decisions at firms employing strict NPV thresholds.

B. Earnings Management and Regulatory Risks

The magnitude of ratio and valuation improvements catalogued in Section IV simultaneously illustrates the earnings management potential of discretionary capitalization. Management can manipulate reported earnings and valuation multiples through the capitalization rate and amortization period choices without altering underlying business economics—a classic form of accruals-based earnings management [21, 22]. The SEC's enforcement history regarding aggressive capitalization (e.g., WorldCom's capitalization of operating expenses) serves as a cautionary precedent. Auditors applying PCAOB AS 2401 are expected to scrutinize the reliability of management's future benefit estimates, particularly for generic brand advertising with diffuse attribution [18].

C. A Decision Framework for Marketing Capitalization

Drawing on the results and literature, we propose a four-criterion decision framework for CFOs evaluating marketing capitalization: (1) Identifiability—can the marketing expenditure be linked to a specific, separable intangible asset? (2) Measurability—are future economic benefits reliably estimable using CLV or attribution models with low uncertainty? (3) Control—does the firm have contractual or legal rights over the resulting asset? (4) Materiality—does the capitalized amount meet a materiality threshold relative to reported assets and earnings? Expenditures meeting all four criteria are strong candidates for capitalization; those meeting only one or two should be expensed to avoid regulatory risk. This framework aligns with IAS 38 recognition criteria while providing operational guidance suited to digital marketing contexts.

D. Implications for Investors and Analysts

Investors and sell-side analysts should be alert to abrupt changes in firms' marketing capitalization practices as potential signals of earnings management, particularly during periods of declining organic growth. Ratio decomposition and free cash flow analysis—which is invariant to capitalization choices—provide important analytical safeguards. The compression of EV/EBITDA multiples observed in Table II illustrates how capitalization can make expensive firms appear attractively valued on surface-level screening metrics.

VI. CONCLUSIONS

This study provides a systematic examination of the accounting, regulatory, and valuation consequences of capitalizing marketing expenditures under GAAP and IFRS frameworks. Simulation evidence demonstrates that capitalization of 30–60% of marketing spend materially improves reported profitability metrics, elevates valuation multiples, and generates more favorable capital budgeting outcomes—with NPV improvements of \$12–53M on a representative \$500M marketing program. However, these benefits are inseparable from earnings management

risk, regulatory scrutiny, and future amortization volatility that can reverse short-term valuation gains.

Practical recommendations include: (1) CFOs should adopt consistent capitalization policies disclosed transparently in footnotes, with sensitivity analysis quantifying the impact on key metrics; (2) auditors should develop marketing-specific audit procedures addressing the reliability of CLV and attribution model inputs; (3) the FASB and IASB should consider limited-scope guidance permitting capitalization of directly attributable customer acquisition costs with definite useful lives. Future research should examine real-world adoption patterns following potential IFRS or GAAP standard updates, as well as the implications of AI-driven marketing attribution technologies.

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