What qualifies as an intangible asset

An intangible asset is an asset that is not physical in nature. Goodwill, brand recognition and intellectual property, such as patents, trademarks, and copyrights, are all intangible assets. Intangible assets exist in opposition to tangible assets, which include land, vehicles, equipment, and inventory. Additionally, financial assets such as stocks and bonds, which derive their value from contractual claims, are considered tangible assets. An intangible asset is an asset that is not physical in nature, such as a patent, brand, trademark, or copyright. Businesses can create or acquire intangible assets. An intangible asset can be considered indefinite (a brand name, for example) or definite, like a legal agreement or contract. Intangible assets created by a company do not appear on the balance sheet and have no recorded book value. An intangible asset can be classified as either indefinite or definite. A company's brand name is considered an indefinite intangible asset because it stays with the company for as long as it continues operations. An example of a definite intangible asset would be a legal agreement to operate under another company's patent, with no plans of extending the agreement. The agreement thus has a limited life and is classified as a definite asset. While an intangible asset doesn't have the obvious physical value of a factory or equipment, it can prove valuable for a firm and be critical to its long-term success or failure. For example, a business such as Coca-Cola wouldn't be nearly as successful if it not for the money made through brand recognition. Although brand recognition is not a physical asset that can be seen or touched, it can have a meaningful impact on generating sales. Businesses can create or acquire intangible assets. For example, a business may create a mailing list of clients or establish a patent. If a business creates an intangible asset, it can write off the expenses from the process, such as filing the patent application, hiring a lawyer, and paying other related costs. In addition, all the expenses along the way of creating the intangible asset are expensed. However, intangible assets created by a company do not appear on the balance sheet and have no recorded book value. Because of this, when a company is purchased, often the purchase price is above the book value of assets on the balance sheet. The purchasing company records the premium paid as an intangible asset on its balance sheet. Intangible assets only appear on the balance sheet if they have been acquired. If Company ABC purchases a patent from Company XYZ for an agreed-upon amount of $1 billion, then Company ABC would record a transaction for $1 billion in intangible assets that would appear under long-term assets. The $1-billion asset would then be written off over a number of years via amortization. Indefinite life intangible assets, such as goodwill, are not amortized. Rather, these assets are assessed each year for impairment, which is when the carrying value exceeds the asset's fair value. According to the IFRS, intangible assets are identifiable, non-monetary assets without physical substance. Like all assets, intangible assets are expected to generate economic returns for the company in the future. As a long-term asset, this expectation extends for more than one year or one operating cycle.Intangible assets lack a physical substance like other assets such as inventory and equipment. They form the second largest category of long-term assets, behind number one – PP&E. They can be separated into two classes: identifiable and non-identifiable.Identifiable and Unidentifiable Intangible AssetsIdentifiable intangible assets are those that can be separated from other assets and can even be sold by the company. They are assets such as intellectual property, patents, copyrights, trademarks, and trade names. Software and other computer-related assets outside of hardware also classify them as identifiable intangible assets.Unidentifiable intangible assets are those that cannot be physically separated from the company. The most commonplace unidentifiable intangible asset is goodwill. Internally generated goodwill is always expensed and never recorded as an asset. However, externally generated goodwill can be recorded as an asset when a company acquires or merges with another company and pays above its fair value. The difference is recorded as goodwill. Such an asset is not depreciated like PP&E. However, it is instead tested for impairment regularly. A company will record an impairment lossGoodwill Impairment AccountingGoodwill is acquired and recorded on the books when an entity purchases another entity for more than the fair market value of its assets. if it deems the goodwill’s value has decreased from its recorded book value.Another key unidentifiable asset is branding and reputation. While a company can sell its trademark, logos, and such, it can be difficult to separate good branding and reputation from a strong company. Nonetheless, brand recognition and reputation are expected to generate good economic returns for the company in the future.Amortization ExpenseWhile PP&E is depreciated, intangible assets are amortized (except for goodwill). These assets are amortized over the useful life of the asset. Generally, intangible assets are simply amortized using the straight-line expenseDepreciation ExpenseWhen a long-term asset is purchased, it should be capitalized instead of being expensed in the accounting period it is purchased in. method.If an intangible asset has a perpetual life, it is not amortized. Consequently, if an intangible asset has a useful life but can be renewed easily and without substantial cost, it is considered perpetual and is not amortized.ExampleMcRonald’s has two intangible assets. The first is a patent worth $25,000,000 and with a useful life of 50 years. The patent expires and cannot be renewed. The second is a trademark worth $1,000,000 and with a useful life of 10 years, after which it expires. However, the trademark can be renewed at a marginal cost. What is McRonald’s amortization expense per year?The trademark is not amortized, as it virtually has a perpetual lifePerpetuityPerpetuity is a cash flow payment which continues indefinitely. An example of a perpetuity is the UK’s government bond called a Consol.. The patent, however, is amortized on the straight-line scale over its 50-year life. The amortization expense is $25,000,000 / 50 = $500,000. Thus, the yearly amortization expense for McRonald’s is $500,000.GoodwillReferring to the identifiable intangible asset definition mentioned earlier, goodwill does not meet the IFRS definition, as it is not identifiable/not separable. However, goodwill is still an intangible asset, treated as a separate class. The main difference concerning goodwill, as compared to other intangibles, is that goodwill is never amortized.In accounting, goodwill represents the difference between the purchase price of a business and the fair value of its assets, net of liabilities.What this essentially means is the difference represents how much the buyer is willing to pay for the business as a whole, over and above the value of its individual assets alone. For example, if XYZ Company paid $50 million to acquire a sporting goods business and $10 million was the value of its assets net of liabilities, then $40 million would be goodwill. Companies can only have goodwill on their balance sheets if they have acquired another business.Government GrantsFinally, another type of intangible asset is government grants. For several reasons, governments at all levels may choose to provide financial assistance to companies that engage in certain activities. The accounting treatment used for grants is either the net method or the gross method. The net method deducts the grant from the assets book value to arrive at the carrying amount of the asset, while the gross method records the asset at its gross value (full purchase price) and sets up the grant as deferred income.Government grants may be in the form of a specific grant that includes specific requirements/stipulations such as employment levels or pollution control levels. If these stipulations are not met, then the grants may need to be refunded by the company. Government grants may also include forgivable loans in situations where companies meet certain conditions.As the name implies, the loan does not need to be repaid. In terms of recognition, government grants should be recognized only if:The entity will comply with the stipulations/requirements attached to them; andThe grants will actually be received.Additional ResourcesThank you for reading CFI’s explanation of Intangible Assets. To keep advancing your career, the additional CFI resources below will be useful:InventoryInventoryInventory is a current asset account found on the balance sheet, consisting of all raw materials, work-in-progress, and finished goods that aTangible AssetsTangible AssetsTangible assets are assets with a physical form and that hold value. Examples include property, plant, and equipment. Tangible assets areMonetary AssetsMonetary AssetsMonetary assets carry a fixed value in terms of currency units (e.g., dollars, euros, yen). They are stated as a fixed value in dollar terms.Net Identifiable AssetsNet Identifiable AssetsNet Identifiable Assets consist of assets acquired from a company whose value can be measured, used in M&A for Goodwill and Purchase Price Allocation.

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