Overview & Objective – The purpose of this TIA is to review current GAAP as it applies to the capitalization of costs incurred for the establishment of intangibles or when such assets are purchased. As a general framework, intangible assets are distinguished as either “by purchase,” or “by internal development” and then as “identifiable,” or “unidentifiable.”

General Application – Broadly speaking there are two classifications of long-lived assets: tangible and intangible. The former maintains physical substance while the latter does not. As costs for tangible assets are capitalized and reported on a company’s Balance Sheet, so too are certain and specific intangible assets. Recognizing the costs associated with creating a portfolio of usable intangibles, and their future benefit to the firm, provides competitive advantages. These advantages are seen in the form of future cash-flows from operations, licensing agreements, and in the event of a company sale (others abound). Companies seeking to add value to their future operations and enhance their exit strategy work to enhance these “unseen” assets by allocating resources, management focus, and R & D efforts to their development. A general framework for accounting for the cost of intangibles follows (FASB Statement No. 142).

Classification of Intangible Assets – Intangibles must be classified according to one of four alternatives as listed below.

<table>
<thead>
<tr>
<th>Classification of Intangible Assets</th>
<th>Acquired</th>
<th>By Purchase</th>
<th>By Internal Development</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type</td>
<td>Identifiable</td>
<td>Unidentifiable</td>
<td>Identifiable</td>
</tr>
<tr>
<td>Examples</td>
<td>• Trademarks</td>
<td>• Service Marks</td>
<td>• Goodwill</td>
</tr>
<tr>
<td></td>
<td>• Trade Names</td>
<td>• Copyrights</td>
<td>• Copyrights</td>
</tr>
<tr>
<td></td>
<td>• Patents</td>
<td>• Patents</td>
<td>• Patents</td>
</tr>
<tr>
<td></td>
<td>• Customer Lists</td>
<td>• Franchise Fee</td>
<td>• Franchise Fee</td>
</tr>
</tbody>
</table>

Determining If Capitalization of Identifiable Intangibles Applies – Costs of developing identifiable intangibles are capitalized if they meet any one of the following tests. Note: As seen below not all costs associated with the development of intangibles are capitalized! Internally developed unidentifiable intangibles are expensed as well as development costs.

2. Provides Legal Rights – Gives legal rights to its owner conveyed by a contract.
3. Exchangeable – Can be independently exchanged (sold).

Determining Treatment of Costs Associated with Intangible Assets – For each class of intangible, costs are treated somewhat differently (general rule above applies).

- **By Purchase** – If the intangible asset is purchased and…
  - **Identifiable**
    - Costs are capitalized
    - Costs are amortized over their useful life
    - Costs are reviewed annually for impairment
  - **Unidentifiable**
    - Costs are capitalized
    - Costs are reviewed annually for impairment
- **Internally Developed** – If the intangible asset is internally developed and…
  - **Identifiable**
    - Costs are capitalized
    - Costs are amortized over their useful life
    - Costs are reviewed annually for impairment
  - **Unidentifiable**
    - Costs are expensed as incurred
**Determining What Costs to Capitalize** – Only certain costs *associated with developing* intangible assets are capitalized. Examples of those include the following:

- **Acquisition** cost of a purchased intangible.
- Legal fees related to *establishing* the intangible.
- Filing costs related to *establishing* the intangible.
- Other costs related to *establishing* the intangible.
- Other **direct and indirect costs associated with developing** the product or process are **NOT capitalized** (*i.e.* Development Costs). They are expensed as R & D costs (FASB Statement No2).

**Further Instruction & Use** – For further information regarding the Capitalization of Intangible Assets contact The NDH Group, Ltd. at 312.461.0876 or [www.ndhcpa.com](http://www.ndhcpa.com)