

Alisha, James, Adam as: Iliad, Alex, Dhrumil

Alisha: Wow! I can't wait to see how our business does next year! We've generated total revenue of 25 million dollars and we've served 1250 clients! We've hired a new accounting grad to help us out!

Alisha: Hey Adam, I've been wondering about how our accounting department is doing, especially in their head. What's the difference between intangible and tangible assets?

Adam: Well Alisha, the difference between intangible and tangible assets is very simple! A tangible asset is an asset with physical substance, and an intangible asset is an asset **without** physical substance. Examples of tangible assets would be Property, Plant & equipment, land, buildings, and trucks. Also things such as mineral deposits, oil, gas, and timber. Examples of intangible assets would be things that have a future economic benefit by the special rights and privileges they provide. Examples would be Patents, copyrights, contracts, trademarks, franchise licenses, and research and development. Another example would be Goodwill, which is essentially the public perception of the brand/company.

Alisha: Cool. What is the difference between operating expenses and capital expenditures?

Adam: The main difference between operating expenses and expenditures is that expenditures are assets that would appear on a balance sheet and operating expenses are expenses that would appear on an income statement. Expenditures (assets) are items that the business deems to have future economic value, increase the efficiency of an existing asset, or extend the expected life of an existing asset. The journal entry for expenditures is to debit the asset and credit either cash or accounts payable. Operating expenses are typically made periodically and maintain the efficiency or useful life of an asset. The journal entry for operating expenses is to debit the expense and credit either cash or accounts payable.

Alisha: Oh wow, how is land valued on the balance sheet?

Adam: Well, land is a tricky one. It cannot be amortized, and the calculation of its cost contains 5 separate items. The items that it includes would be the purchase price, closing costs such as title & legal fees, accrued property taxes and other liens, all costs incurred in making the land ready for its intended use, and finally land improvements. Land improvements would be any necessary expenditures to make the improvements ready for their intended use, such as parking lots, fencing, landscaping, and lighting. The cost principle states that the asset, which in this case is the land, is recorded at the price at which it was acquired, not its perceived market value. This also complies with the matching principle, which states that a business' expenses can only be compared against the revenues of the same period.

James: Given that we bought 3 vehicles for a combined \$150,000 5 years ago that all have a useful life of 10 years. The accumulated amortization is \$75,000 under straight-line and 20% under declining balance. So, amortization is the process of allocating the cost of an asset to an expense account over the period of its useful life. Amortization is required by the matching principle because expenses need to be matched with their corresponding

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revenues. Accumulated amortization is the total sum of amortization expense recorded for an intangible asset. In other words, it's the amount of costs that have been allocated to the asset over its useful life. Useful life is the estimated lifespan of a fixed asset, during which it can be expected to contribute to company operations. The residual value is the estimated value of a fixed asset at the end of its useful life. Straight-line amortization is calculated with the formula;

$$(Net\ Book\ Value - Salvage\ Value) / Useful\ Life$$

If we used the declining balance method at a declining balance of 20%, we would get the formula;

$$Net\ Book\ Value * 20\%$$

So, if we use this method we arrive at an accumulated amortization of 100,848 instead of 75,000.

Journal Entries to show amortization at the end of the year

DR Amortization Expense	9830.40	
CR Accumulated Amortization		9830.40

Alisha: Oh wow I think I learned a lot.

Alisha: Hey James, Adam, I think this is the truth. Capital assets can be disposed of through one of three methods: retirement, sale, or exchange. Retirement is when the asset is simply thrown out and abandoned. Sale is when the asset is sold, and exchange is when the asset is exchanged for something of equal value. The net book value(NBV) is the original cost of the asset minus the accumulated amortization of that asset. To calculate gain or loss, compare the asset's net book value against how much money you made from sales.

Adam: And here's how you journalize: If the net book value is greater than this value, you debit cash and acc. Amortization, and credit the asset and the gain on asset disposal. If the net book value is lower, you debit the same accounts and now debit loss on asset disposal and credit asset.

James: Aw we worked so hard to get that land with all that information, but we can't amortize land! Therefore, we can't amortize it with the straight-line method or any method. And we can take a look at the chart to see the amortization schedule and journal entries for our small building purchase.