## Have We Forgotten Fixed Asset Accounting 101?

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If the final exam of your very first accounting class asked the following question, I suspect few of us would have gotten it wrong.

Your company purchases a machine for \$140,000. Your operations manager estimates the company will use the machine for 15 years. He estimates a similar 15 year-old machine today would sell for \$20,000. What would be the machines 1<sup>st</sup> year depreciation?

Answer: (\$140,000-\$20,000)/15 = \$8,000

The math is simple. In a final exam, almost no one would get this question wrong. However, I know almost no U.S. accountant would do this calculation in the real world.

In the last two years I have asked hundreds of accountants how many routinely recognize residual value in their depreciation calculations. In a room full of veteran financial managers, rarely will a hand go up. When I ask how many people have EVER seen residual value used, one out of 30 might say they saw it done, ONCE, early in their careers.

When I ask, how many people would use 15-year depreciation for a fifteen-year asset, rarely will ANY hands go up. When they do, the company is often large and public. Most accountants respond they would use seven-year tax life for a fifteen-year asset. Thus, the calculation real world accountants do is:

## Real World Practice: \$140,000/7 years is \$20,000/year.

This is not an extreme example. In my first Controller job, my company use metal stamping presses having a 40-50 year useful life. My predecessor depreciated this equipment over 5 years with no residual value. As a result, we had huge book to fair value differences on our balance sheet. I thought I was being much more realistic by increasing the depreciable lives of our assets, first to seven years and then to 10. Being "conservative", I never seriously considered recognizing a residual value or depreciating the equipment over 40 years.

In many small companies, the situation is even worse. When a company uses tax depreciation for book, all of the Section 179 assets the company expenses for tax purposes have no value.

Our ultra conservative accounting obscures the true economics of the company's business. How many times have small companies had to hire appraisers to verify the value of their assets because the bank could not rely on the company's financial statements for a fair representation of the company's assets? How often has our CEO come in to our office looking for ideas to improve the bottom line or the company's balance sheet?

Perhaps it is time we went back to the basics and calculated depreciation the way our accounting standards read.

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