Depreciation reporting

In an accountant's reporting systems, depreciation of a business's fixed assets such as its buildings, equipment, computers, etc. is not recorded as a cash outlay. When an accountant measures profit on the accrual basis of accounting, he or she counts depreciation as an expense. Buildings, machinery, tools, vehicles and furniture all have a limited useful life. All fixed assets, except for actual land, have a limited lifetime of usefulness to a business. Depreciation is the method of accounting that allocates the total cost of fixed assets to each year of their use in helping the business generate revenue.

Part of the total sales revenue of a business includes recover of cost invested in its fixed assets. In a real sense a business sells some of its fixed assets in the sales prices that it charges it customers. For example, when you go to a grocery store, a small portion of the price you pay for eggs or bread goes toward the cost of the buildings, the machinery, bread ovens, etc. Each reporting period, a business recoups part of the cost invested in its fixed assets.

It's not enough for the accountant to add back depreciation for the year to bottom-line profit. The changes in other assets, as well as the changes in liabilities, also affect cash flow from profit. The competent accountant will factor in all the changes that determine cash flow from profit. Depreciation is only one of many adjustments to the net income of a business to determine cash flow from operating activities. Amortization of intangible assets is another expense that is recorded against a business's assets for year. It's different in that it doesn't require cash outlay in the year being charged with the expense. That occurred when the business invested in those tangible assets.