

# Essay on straight-line depreciation method

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## Calculating straight-line depreciation

Straight-line depreciation method is a way of computing the amortization (depreciation) expenses of a fixed asset over a given time period. This function is obtained by taking salvage value from the purchase price and then dividing the result by projected number of years that the asset will be in service; that is, depreciation expense (\$/year) = (initial asset cost less salvage value)/service years.

The service years are the number of years the asset is productive and of benefit to the company or organisation. Salvage value is the estimated value that an asset will realize upon its sale at the end of its useful life. Initial asset cost is the amount of money used to acquire a new asset inclusive of all other costs, that is, installation, setup, and shipping costs needed to put the asset into service.

Example: suppose an organisation wishes to install a voice system and the cost is estimated to be \$1, 500, 000. The salvage value is estimated to be \$200, 000 at the end of its useful life and five-year useful economic life.

Therefore, the annual depreciation charge is as follows:

Depreciation expense (\$/year) = (initial cost-salvage value)/service years.

$$= (1, 500, 000-200, 000)/5$$

$$= \$260, 000$$

Hence, in the accounts of the business a value of \$260, 000 will be expensed in the profit and loss account as depreciation charge annually for the five

years of the assets useful life.

Apart from the straight-line depreciation formula, there is the compound formula where the depreciation is calculated by taking in the reduction that is experienced every year. These calculations help to know the rate at which an asset loses value.

## **Bibliography**

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