Business-owned property

Business

Depreciation is the systematic and rational allocation of tangible asset cost over the periods benefited by the use of the asset (Smith, Stice, Skousen & Skousen, 1998). The objective of depreciation is to have each period benefiting from the use of the asset bear an equitable share of the asset cost. There are a number of methods for allocating the costs of depreciable assets. The most common are the straight-line, declining balance, and the units of production method.

Straight-line depreciation relates cost allocation to the passage of time and recognizes equal periodic charges over the life of the asset (Smith et al., 1998). The straight-line approach considers depreciation as a function of time rather than as a function of usage. Asset cost less the residual or salvage value equals the depreciable cost of the asset. Depreciable cost divided by the asset’s useful life gives the amount of periodic depreciation of the asset.

The declining balance method of depreciation provides decreasing charges by applying a constant percentage rate to a declining asset book value. The most common rate used is 2 times the rate of the straight-line depreciation or called the “ 200% declining balance method”. Residual or salvage value is not considered in the computation of depreciation rate, but depreciation charges should stop once the book value is equal to the residual value. To compute for the annual depreciation rate, divide the asset cost by the useful life then multiply by 200%. To get the annual depreciation charges, simply multiply the depreciation rate by the book value of the asset.

Unit of production method of depreciation is based on the theory that an asset is acquired for the service it can provide in the form of production output (Smith et al., 1998). Under this method, a depreciable rate is computed by dividing the depreciable cost of the asset by its estimated life in terms of units of production. The depreciation rate per unit multiplied by the yearly output equals the annual depreciation.

Reference:

Smith, J., Skousen, K. F., Stice, E., & Stice, J. (1998). Noncurrent operating asset-utilization and retirement. *Intermediate accounting* (pp 486-492). South Western