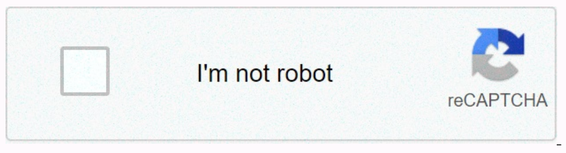

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Reducing balance method formula accounting

What is the formula for calculating reducing balance method. Reducing balance method formula example. What is reducing balance method.

The declining balance or reducing balance depreciation method considers the value of assets that are largely used or highly contribute to operation at the beginning and then subsequently decline.That means depreciation expenses that should be charged to certain types of assets are high at first and then low subsequently.This is the main principle of this depreciation. In other words, the depreciation expenses are subsequently decreased until the value is zero or reaches the residual values.Declining balance or reducing balance depreciation method means the same thing. Some people call the declining balance method and some people called the reducing balance method.However, the way how we calculate the depreciation expenses is the same. We will discuss the detail of this method in this article.Does this depreciation method allow by IFRS?Well, under IAS 16, there are three methods were mentioned. They are the straight-line method, the diminishing balance method, and the units of production method.Declining balance and reducing is the way how the diminishing balance method is calculated. That means this method is allowed.The declining balance formula is quite easy to use and remember if you really understand the principle of it. The following is the formula,Declining balance formula;Depreciation Expenses = (Net Books – Residual Value) * Depreciation RateDepreciation expenses are the expenses that charged to assets for a specific period or based on specific systematic ways.Carrying Value of Assets is equal to the book value of assets less accumulated depreciation. Carrying Value of Assets is sometimes called the Netbooks Value of Assets.Residual value is the value of assets that should remain at the end of its useful life based on expectations.Depreciation Rate is the rate provided to certain types of assets. 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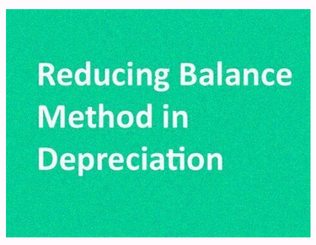
This method is especially suitable to assets with long life, e.g., plant and machinery, furniture, motor car etc. Under this method the real cost of using an asset is the depreciation and repair expenses so this method gives better results because in early years when repair expenses are less the depreciation is more. caneba As the asset gets older repair charges on it increases and the amount of depreciation decreases. So the combined effect of both these costs remain almost constant on the profit and loss of each year.



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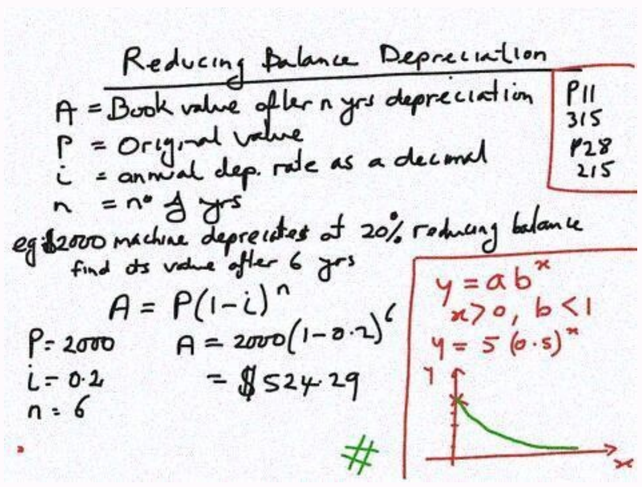

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$$DB = 1 - \sqrt[Years]{\frac{SalvageValue}{Cost}}$$

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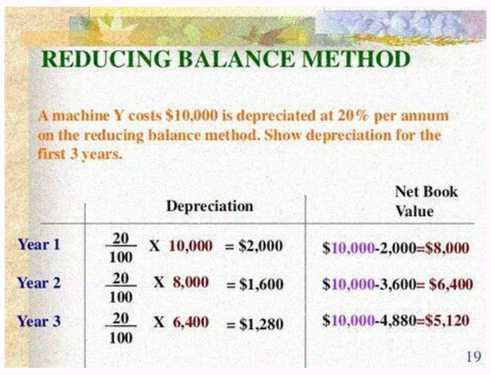

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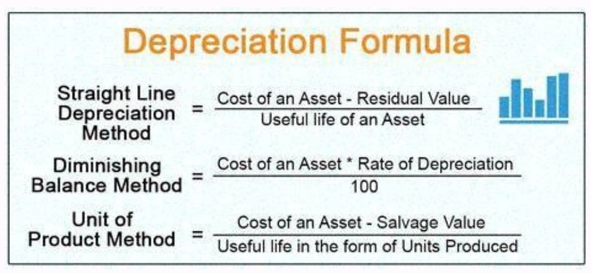

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The great weakness of this method is that it takes very long time to write off an asset to approximately nil, unless a very high rate is used, in which case the burden on earlier years shall be excessive. This method is used by income tax authorities for granting depreciation allowance to assesses. Formula for the Calculation of Depreciation Rate: The calculation of correct rate of depreciation is very important under this method. Following formula should be applied under given conditions: When the cost of asset, residual value and useful life of an asset is given: r = 1 - (S/C)1/n Where: r = Rate of depreciation n = Estimated useful life of asset S = Residual value after the expiry of useful life C = Original cost of asset Example 2: If n = 3 years, S = 64,000 and C = 1,000,000 calculate rate of depreciation.
r = 1 - (64,000/1,000,000)1/3 = 1 - 40/100 = 60/100 = 60% Difference Between Straight Line Method and Reducing Balance Method: Following are the main points of difference between straight line method and reducing balance method of depreciation: Straight Line Method Reducing Balance Method 1. The rate and amount of depreciation remain the same each year. 1. The rate remains the same, but the amount of depreciation diminishes gradually. 2. Depreciation rate per cent is calculated on cost of assets each year 2. Depreciation rate per cent is calculated on book value of asset. 3. At the end of its life the value of asset is reduced to zero or scrap value. 3.
The value of asset is never reduced to zero at the end of its life. 4. The older the asset the larger the cost of its repair. But the amount of depreciation remain the same each year. Hence, the total of depreciation and repairs increases every year.
This reduces annual profit gradually.
4. The amount of depreciation decreases gradually, while the cost of repairs increases. So the total of depreciation and repairs remain more or less the same each year.
Hence, it causes little or no change in annual profit/loss. 5. Computation of depreciation under straight line method is comparatively easy and simple. 5. Depreciation can be computed without any difficulty, but it is not easy and simple. Under the reducing balance method, the amount of depreciation is calculated by applying a fixed percentage on the book value of the asset each year. In this way, the amount of depreciation each year is less than the amount provided for in the previous year. This is because the book value used to compute the depreciation expense is continually reduced from year to year. Reducing Balance Method: Formula Use the following formula to calculate depreciation under the reducing balance method: Depreciation = Asset book value x Depreciation rate Where: Depreciation is the dollar amount lost in valueAsset book value is the value of the asset for accounting purposesDepreciation rate is the percentage decline in the asset's value Example: Calculating Depreciation Under Reducing Balance Method On 1 January 2016, XYZ Limited purchased a truck for $75,000. Depreciation is estimated at 20% per year on the book value. Required: Calculate the truck's depreciation for 2016, 2017, and 2018. Solution 2016 The book value at the beginning of 2016 is $75,000. Depreciation for 2016 is $75,000 × 0.2 = $15,000. 2017 The book value at the beginning of 2017 is $75,000 - $15,000 = $60,000. Depreciation for 2017 is $60,000 × 0.2 = $12,000. 2018 The book value at the beginning of 2018 is $60,000 - $12,000 = $48,000. Depreciation for 2018 is $48,000 × 0.2 = $9,600.
Notes Notice that the depreciation provided in 2018 ($9,600) is less than the amount of depreciation provided in 2017 ($12,000). In turn, this is less than the amount provided in 2016 ($15,000).
The reason for this is that the rate of depreciation (20% in this case) is being applied to the book value, which continually reduces each year. In 2016, the book value was $75,000, while in 2017, it fell to $60,000. A year later, it reduced to $48,000. Remember that the rate of depreciation remains constant but it is applied to a lesser amount (i.e., book value) each year. Hence, the amount of depreciation each year is lower. The reducing balance method is also known as the reducing installment method. It is especially useful for fixed assets whose value deteriorates faster in the earlier years of usage (e.g., cars, office equipment, and small machinery).