

Example on Computation of Depreciation

Depreciation of each fixed asset can be calculated using the method approved by the MC. Two simple and commonly used methods are shown below:

Straight-line Method

Evenly distribute the cost of a fixed asset, less the expected final disposal value (if any), over its expected useful life:

$$\text{Depreciation charge} = \frac{\text{cost of fixed asset} - \text{expected disposal value}}{\text{useful life}}$$

(note: expected disposal value could be \$0)

Reducing Balance Method

Apply a fixed rate (percentage) of depreciation to the asset each year:

$$\text{Depreciation charge} = \text{net book value} \times \text{rate of depreciation}$$

Example

Cost of equipment = \$8,000
 Estimated useful life = 4 years
 Expected disposal value at the end of useful life = \$500
 Depreciation rate for reducing balance method = 50%

| | Straight-line Annual depreciation = (\$8,000-\$500) / 4 HK\$ | Reducing Balance Annual depreciation = net book value x 50% HK\$ |
|--------------------------------|--|--|
| Cost | 8,000 | 8,000 |
| Depreciation - year 1 | 1,875 | 4,000 |
| Net book value | 6,125 | 4,000 |
| Depreciation - year 2 | 1,875 | 2,000 |
| Net book value | 4,250 | 2,000 |
| Depreciation - year 3 | 1,875 | 1,000 |
| Net book value | 2,375 | 1,000 |
| Depreciation - year 4 | 1,875 | 500 |
| Net book value (diposal value) | 500 | 500 |

| Accounting Entries for Depreciation (Year 4) | Dr | Cr |
|--|---------|---------|
| DR. Depreciation | \$1,875 | |
| CR. Accumulated Depreciation | | \$1,875 |