Chapter 6

The Declining Balance (DB) Method of Depreciation

Sometimes a company knows that an asset will be more efficient in its early years than in its later years. For example, computerized equipment may be used extensively when first acquired, then either quickly becomes obsolete or is used much less when more advanced equipment becomes available.

The solution is to use a depreciation method that provides most of the depreciation in the early years of use and less in later years. Two methods that accelerate depreciation are the declining balance (DB) method, covered in this chapter, and the sum-of-the-years'-digits (SYD) method, covered in chapter 7.

Calculating Depreciation Under the Declining Balance Method

The depreciation rate for the DB method is a multiple of the straight-line (SL) rate. Although any percentage may be used, the most common declining balance rates are:

- 200% -2.0 x straight-line rate; or
- 150% -1.5 x straight-line rate; or
- 125% -1.25 x straight-line rate.

The most widely used rate is 200%, referred to as the "Double-Declining Balance" (DDB) method because it is double the straight-line rate. Whatever rate a company selects - 200%, 150%, 125%, or another rate; it must be used over the entire life of the asset. This method derives its name from the fact that a *constant percentage* factor of twice the straight-line rate is applied each year to the *declining balance* of the asset's book value. This method is accepted by the IRS and will be discussed in later chapters.

How Depreciation Is Computed Under the Declining Balance Method

The DB method is different from the SL, units of production (UOP) or sum-of-the-years'-digits methods because the depreciation rate is multiplied by the *book value*, not the depreciable base. Because the book value declines each year, it is called the Declining Balance Method (DB).

To compute depreciation expense under DDB, multiply the depreciation rate by the book value not the depreciable cost as in the straight-line and units of production methods. The total depreciation permitted for an asset, however, is limited to the depreciable base as in the other methods. To put it another way, the asset cannot be depreciated below it's residual value, as in the other methods.