

Provided by
ACCA Research Institute



ACCA F9

Financial Management (FM)

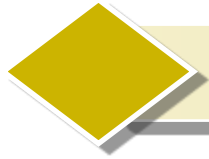
财务管理

ACCA Lecturer: Sinny Shao





Part D : investment appraisal



Example question



Example question: June 2008 Q2

PV Co is evaluating an investment proposal to manufacture Product W33, which has performed well in test marketing trials conducted recently by the company's research and development division. The following information relating to this investment proposal has now been prepared.

Initial investment	\$2 million
Selling price (current price terms)	\$20 per unit
Expected selling price inflation	3% per year
Variable operating costs (current price terms)	\$8 per unit
Fixed operating costs (current price terms)	\$170000 per year
Expected operating cost inflation	4% per year



Example question

The research and development division has prepared the following demand forecast as a result of its test marketing trials. The forecast reflects expected technological change and its effect on the anticipated life-cycle of Product W33.

Year	1	2	3	4
Demand(unit)	60000	70000	120000	45000

It is expected that all units of Product W33 produced will be sold, in line with the company's policy of keeping no inventory of finished goods. No terminal value or machinery scrap value is expected at the end of four years, when production of Product W33 is planned to end. For investment appraisal purposes, PV Co uses a nominal (money) discount rate of 10% per year and a target return on capital employed of 30% per year. Ignore taxation.



Example question

- (a) Identify and explain the key stages in the capital investment decision-making process, and the role of investment appraisal in this process. (7 marks)**
- (b) Calculate the following values for the investment proposal:**
- (i) net present value;**
 - (ii) internal rate of return;**
 - (iii) return on capital employed (accounting rate of return) based on average investment; and**
 - (iv) discounted payback period.(13 marks)**
- (c) Discuss your findings in each section of (b) above and advise whether the investment proposal is financially acceptable. (5 marks)**



Steps for making an investment decision:

- ◆ Complete and submit standard format financial information as a formal investment proposal.
- ◆ Classify the project by type
- ◆ Carry out financial analysis of the project.
- ◆ Compare the outcome of the financial analysis to predetermined acceptance criteria
- ◆ Consider the project in the light of the capital budget for the current and future operating periods
- ◆ Make the decision
- ◆ Monitor the progress of the project



Calculation of return on capital employed

Total cash inflow = $560,000 + 696,028 + 1,350,773 + 392,874 = \$2,999,675$

Total depreciation and initial investment are same, as there is no scrap value

Total accounting profit = $2,999,675 - 2,000,000 = \$999,675$

Average annual accounting profit = $999,675/4 = \$249,919$

Average investment = $2,000,000/2 = \$1,000,000$

Return on capital employed = $100 \times 249,919/1,000,000 = 25\%$



Thank You!

