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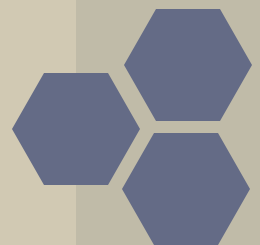


ACCA F9

Financial Management

财务管理

ACCA Lecturer: Sinny Shao





Part D investment appraisal

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Investment decisions without DCF

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Investment decisions with DCF

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Project appraisal and risk





Investment decision—without cash flow discount

Investment:

Capital expenditure is expenditure which results in the acquisition of non-current assets or an improvement in their earning capacity.

Revenue expenditure is charged to the statement of profit or loss, and is the expenditure occurred for the purpose of the trade of the business or to maintain the existing earning capacity of non-current assets

Investments can be made for non-current assets or for working capital.





Investment decision——without cash flow discount

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





Investment decision——without cash flow discount

Relevant cash flow——important for investment decision

Relevant costs of investment appraisal include:

- opportunity costs
- working capital
- Other relevant costs

Infrastructure costs

Marketing costs

Human resource costs

Additional specific fixed costs

Any costs which do not represent an actual cash flow should also be ignored





Investment decision——without cash flow discount

Relevant benefits of investments:

- Cash inflow
- Saving of costs
 - staff cost
 - operating costs
- better relationships with customers and employees
- intangible benefits





Investment decision——without cash flow discount

Payback period:

未考虑货币的时间价值

the time it takes the cash inflows from a capital investment project to equal the cash outflows, and usually expressed in years

The organization might have a target payback

	project P	project Q
capital investment	60,000	60,000
profits before depreciation		
Y1	20,000	50,000
Y2	30,000	20,000
Y3	40,000	5,000
Y4	50,000	5,000
Y5	60,000	5,000





Investment decision—without cash flow discount

Advantage of payback period:

- simple to calculate and understand.
- It uses cash flows rather than accounting profits.
- first stage in eliminating obviously inappropriate projects.
- minimize both financial and business risk.
- identify those projects which generate additional cash for investment quickly.

Disadvantage of payback period:

- ignores the cash flows after the end of payback period
- ignores the time value of money
- unable to distinguish between projects with the same payback period
- lead to excessive investment in short-term projects
- Not takes account of the variability of those cash flows





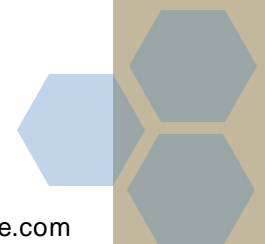
Investment decision—without cash flow discount

ROCE:

$$\text{ROCE} = \frac{\text{Estimated average annual accounting profits}}{\text{Estimated average investment}} \times 100\%$$

$$\text{Average investment} = \frac{\text{Capital cost} + \text{disposal value}}{2}$$

	project X	project Y
capital costs	80,000	150,000
life	5years	5years
profits before depreciation		
Y1	50,000	50,000
Y2	50,000	50,000
Y3	30,000	60,000
Y4	20,000	60,000
Y5	10,000	60,000





Investment decision—without cash flow discount

Solution

	<i>Item X</i> \$	<i>Item Y</i> \$
Total profit over life of equipment		
Before depreciation	160,000	280,000
After depreciation	80,000	130,000
Average annual profit after depreciation	16,000	26,000
Average investment = (Capital cost + disposal value)/2	40,000	75,000
ROCE	40%	34.7%

Both projects would earn a return in excess of 30%, but since item X would earn a bigger ROCE, it would be preferred to item Y, even though the profits from Y would be higher by an average of \$10,000 a year.





Investment decision—without cash flow discount

真题变形：

A company is evaluating an investment project with the following forecast cash flows:

Year	0	1	2	3	4
Cash flow (m)	(6.5)	2.4	3.1	2.1	1.8

Calculate the payback period and ROCE





Investment decision—without cash flow discount

If a machine with annual running costs of \$100,000, was diverted from producing output selling for \$50,000 to producing a special order worth \$70,000, what would be the relevant costs of what has happened?

- A \$170,000
- B \$100,000
- C \$50,000
- D \$20,000





Thank You!

