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Investment appraisal sample questions and answers

Table of Contents In this section are a series of questions on the topic - Investment appraisal. The questions may include various types of questions. For example: Self-test questions - on-screen questions that give immediate marking and feedback Short-answer questions - a series of short-answer questions to help you check your understanding of the topic Case study - a case study with associated questions In the news - questions based around a topical business news article Click on the right arrow at the top or bottom of the page to work through the questions. [Skip Breadcrumb Navigation] No Frames Version Chapter 15: Investment appraisal and the capital budget Academia.edu uses cookies to personalize content, tailor ads and improve the user experience. By using our site, you agree to our collection of information through the use of cookies. To learn more, view our Privacy Policy.× 17 Questions | Total Attempts: 167 A machine which cost \$20,000 was sold after 5 years for \$5,000 and by this time tax allowable depreciation of \$17,000 had been claimed. Rate of tax is 30%. What is the cash flow arising as a result of tax implications on the sale of the machine? The IRR method ignores the relative size of investments, True or False? Which ONE of the following is included in the cash flows when determining the net present value of a project? Depreciation charges for the equipment Disposals value of the equipment Using a cost of capital of 9%, the NPV of a project turned out to be \$4,300. Using a rate of 12%, the NPV of the project is (\$2,230). What is the IRR of the projects? A company is considering a project which will earn cash flows of \$60,000 in Year 1 and \$80,000 in Year 2 but will require capital investment of \$100,000 today. What is the NPV of the project if the cost of capital is 15%? The rate of return is 12%. Cash inflow in the second year is \$50,000 and in the third year \$40,000. What is the present value of these future returns? The Fisher formula is : (1+i)=(1+ _r)(1+h). What does the letter 'h' stand for in this formula? If the cash flows are expressed in terms of the actual number of dollars that will be received or paid on the futures dates, we use the real rate for discounting. True or False Where there are conventional cash flows IRRs are possible, True or False A cash outlay or receipt that occurs at the beginning of the time period is taken to occur at: A company is considering the following project. Cost of asset:\$100,000, Estimated life:4 years and Profit before depreciation is \$125,000 over the 4 years. Capital asset is depreciated by 25% of its cost each year. What is the ROCE (based on average investment)? ABC Ltd requires a return of 3% per year. ABC Ltd is located in a country where inflation is expected to be 8% per annum. What nominal rate of return is required by ABC Ltd to get a real return of 3%? What is the present value of \$100,000 cash inflows per annum in perpetuity when the organisation's cost of capital is 15%? A machine has annual running costs of \$50,000 and is producing output which is selling for \$20,000. If this machine is now diverted to produce a special order worth \$30,000, what would be the relevant cost? Revenue expenditure may be incurred to maintain the earning capacity of existing non-current assets, True or False? Section BAnswer Any Two Questions5 An investor is offered the right to buy a distribution asset. The building has just beenlet on a 15 year full repairing and insuring lease with upward only rent reviews everyfive years at a rent of £150,000 payable annually in arrears. The asking price is£3,000,000.The investor has asked you to advise them how much their maximum bid could bebefore deduction of costs and fees (i.e. ignore costs and fees). They have a five yearholding period. They estimate that rental growth in the location will be 3% per annum, depreciation is estimated at 1% per annum and that the exit yield will be 5%.Their target rate of return is 7%.1. Estimate the Investment Value of the asset. (75% of marks)Year Income Sale priceNet Cash flowPVfactorDscst cashflow1 £150,000 £150,000 0.9346 £140,1872 £150,000 £150,000 0.8734 £131,0163 £150,000 £150,000 0.8163 £122,4454 £150,000 £150,000 0.7629 £114,4345 £150,000 £3,312,242 £3,462,242 0.7130 £2,468,531Investment Value £2,976,613II. Briefly discuss the main factors affecting the choice of target rate of return(25% of marks) Should discuss the components of a target rate of return1 Return for investing – giving up funds – loss of liquidity plus 2 Return for anticipated inflation – loss of purchasing power plus3 Return for risk – risk premiumGovt bonds as (risk free investments) tend to cover 1 and 2. However, otherinvestments (shares and property) have a risk premium.You may note that many organisations have a target rate of return set by clients orthey may have to match a benchmark i.e. they have to beat the IPD index orsomething similar.6 “You may prove anything by figures” - Thomas Carlyle, Scottish writer (1795 - 1881)Many students try to include aspects of investment appraisal in their Internal Assessment (mainly the HL IA, but not uncommon for the SL IA). As with all business management tools, theories and techniques, investment appraisal (if used) must be relevant to the research question and add value to the IA.In addition, the investment appraisal techniques in the syllabus (the payback period, average rate of return, and net present value) are best applied to the purchasing decision of a fixed asset, rather than for a complete projects which could include both fixed and non-fixed assets. In other words, investment appraisal in the IA works better for decisions about capital expenditure rather than revenue expenditure.Above all, if you use quantitative analysis in your IA, make sure the information is meaningful and adds value to the research question.Return to the Unit 3 Finance & Accounts homepage

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