Accounting

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Gary Speed can do a host of things, next time the capital acquisition plan is proposed. This time, the equipment performed as expected, but at the same time Return on Investment or ROI was lower than expected. This is because of the unique way the firm is appraising its capital project. For example, depreciation is normally considered a fixed expense, but in this case, it is being used to calculate the contribution. In other words, the company policy of charging and discriminating fixed and variable costs are different as this has caused the performance of the newly purchased capital expenditure to be lower than expected. This has affected the performance of entire divisions ROI. The company should therefore be more careful in selecting assets in the future in order to make sure that its ROI remains high at all the times.

The performance of the newly purchased capital item could also be low because the company is charging too high depreciation in the early years. Although depreciation does not incur any outward cash flow, but it is recorded in order to get the tax advantage. The company can lower the depreciation amount for the capital item in order to improve the divisional ROI accruing for the Capex (Capital Expenditure). Gary Speed can improve the performance of future Capital Acquisitions by keeping in mind the depreciation and ROI calculation policies of the company. Since these policies are little different from the market, Gary Speed will have to change his accounting practices and way of thinking accordingly in order to predict a more accurate ROI and cost saving plan from the new purchase. Gary Speed can improve the ROI from the capital expenditure by lowering down the depreciation of the assets in the first year. He can charge lower depreciation in the earlier years and higher depreciation in the future years in order to show to the board that the purchase is performing as well as expect .

Gary Speed can also formulate a new plan for calculating ROI. He should make changes to the way EverGreen Corporation calculates the ROI on its Capex. One great of calculating the accurate ROI from the capital purchase or a project is by using the IRR or internal rate of return method. Gary Speed can use this method in order to get the accurate picture of ROI and profitability potential of new purchases. This way he can be sure that the ROI from the project is neither overstated nor understated. This will give the accountants in the company and managers a better ground to base their decisions upon. Currently, the system of calculation is flawed and even the best of the decision might not yield the expected results because of irregularities in the framework used to assess the profitability and returns on investment from a new purchase. Since depreciation is a fixed cost, it cannot be subtracted from the earning potential of the asset to arrive at the contribution from the asset. Hence the methodology used by the company is flawed and the ROI obtained does not give a fair picture.

References:

Randall, Harold. Accounting. New York: Prentice, 1994.

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