

# [Planning for capital investments is an important function of management- eassy qu...](https://assignbuster.com/planning-for-capital-investments-is-an-important-function-of-management-eassy-question/)

1. Planning for capital investments is an important function of management.?  You are responsible for considering purchasing a new exhibit.?  It would cost $136, 000 and have an estimated useful life of 5 years.

?  The salvage value is $70, 000.?  It is expected to increase net annual cash flows by $25, 000.?  The borrowing rate is 8%.?  The cost of capital is 10%.?  Calculate the net present value of this project.?  (1) Explain the pros and cons of using this method to evaluate a capital expenditure (10 points) and (2) show all computations required to arrive at the correct solution. (15 points).

? (Points : 25)? ? ? Answer: For this project we have know how the rules of capital expenditure works. The annual rate of return is one of them. The annual rate of return technique is based directly on accounting data. It indicates the profitability of a capital expenditure by dividing expected annual net income by the average investment.

The net present value (NPV) method involves discounting net cash flows to their present value and then comparing that present value with the capital outlay required by the investment. The difference between these two amounts is referred to as net present value (NPV). Company management determines what interest rate to use in discounting the future net cash flows. Cash Flows ? 10% = Present Value Present value of net annual cash flows = 25, 000 ? 3. 79079 = 94, 770 Present value of salvage value = 70, 000 ? . 62092 = 43, 464 total= (94, 700+43, 464)= 138, 234Capital investment = 136, 000 Net present value= 138, 234-136, 000= 2, 234