## Review Classmates: Module 2 Mini-Project

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| --- | --- |
| **Reviews** | 11 complete |

**Well done!**

You've sent 11 classmates valuable feedback that will help them improve. You can review another submission below or you can continue the course.

Module 2 - Mini-Project



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Submitted on April 27, 2016

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### Part 1

Cut Here, Inc. is considering a new video rendering system for their in-house studio. Currently, there are two options. Each option involves a significant investment in an asset that has a multi-year useful life. The key benefits of each option are cash savings, which Cut Here equates to cash inflows (i.e., compared to the status quo scenario, in which it incurs significant costs in terms of labor, time, etc.).

Use the cash flow information provided in the Assignment Details section of the **Instructions** tab.

Then, use the following measures to assess the two options from a financial perspective. That is, compute the following measures for each option.

* Payback
* Accounting rate of return
* Net present value
* Internal rate of return

**Payback:**

A:  
Initial investment: $100,000  
Year 1: -$10,000  
 $90,000  
Year 2: -$50,000  
 $40,000  
Year 3: -$20,000  
 $20,000  
Year 4: -$70,000  
 $50,000  
Payback = 3.29 years  
  
B:  
Initial investment: $250,000  
Year 1: -$1,000  
 $249,000  
Year 2: -$2,000  
 $247,000  
Year 3: -$3,000  
 $244,000  
Year 4: -$1,000  
 $243,000  
Year 5: -$20,000  
 $223,000  
Year 6: -$390,000  
 $167,000  
Payback = 5.57 years  
  
**Accounting Rate of Return:**

A:  
Expense => $100,000 / 6 years = $16,667 / yr  
Return => $240,000 / 6 years = $40,000 / yr  
(40,000 - 16,667) / 100,000 = 23.33% rate of return  
  
B:  
Expense => $250,000 / 6 years = $41,667 / yr  
Return => $417,000 / 6 years = $69,500 / yr  
(69,500 - 41,667) / 250,000 = 11.13% rate of return  
  
**Net Present Value:**

Assuming a management expected rate of return of 16%:

|  |  |  |
| --- | --- | --- |
|  | A (NPV=.16) | B (NPV=.16) |
| 0 | (100,000.00) | (250,000.00) |
| 1 | 8,620.69 | 862.07 |
| 2 | 37,158.15 | 1,486.33 |
| 3 | 12,813.15 | 1,921.97 |
| 4 | 38,660.38 | 552.29 |
| 5 | 38,089.04 | 9,522.26 |
| 6 | 4,104.42 | 160,072.48 |
| Total | 39,445.83 | (75,582.60) |

**Internal Rate of Return:**

|  |  |  |
| --- | --- | --- |
|  | A (NPV=.278) | B (NPV=.091) |
| 0 | (100,000.00) | (250,000.00) |
| 1 | 7,824.73 | 916.59 |
| 2 | 30,613.17 | 1,680.28 |
| 3 | 9,581.59 | 2,310.19 |
| 4 | 26,240.65 | 705.83 |
| 5 | 23,465.82 | 12,939.16 |
| 6 | 2,295.17 | 231,268.30 |
| Total | - | - |

* Option A requires an Internal Rate of Return of 27.8%
* Option B requires an Internal Rate of Return of 9.1%

Read the response to Part 1 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 points: No answer, completely irrelevant answer.
* 5 pts - 5 points: Insufficient, incomplete, lacks supporting evidence.
* 7 pts - 7 points: Passing, meets expectations.
* 9 pts - 9 points: Well above average, exceeds expectations.
* **10 pts - 10 points: Superior performance, excellent.**

### Part 2

Based on what you calculated in Part 1, which option would you recommend to Cut Here management?

For all four methods of calculation, payback rate, accounting rate of return, net present value and internal rate of return, option A is the recommended option for Cut Here.

Read the response to Part 2 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 points: No answer, completely irrelevant answer.
* **5 pts - 5 points: Insufficient answer, incomplete, lacks supporting evidence.**
* 7 pts - 7 points: Passing, meets expectations.
* 9 pts - 9 points: Well above average, exceeds expectations.
* 10 pts - 10 points: Superior performance, excellent.

### Part 3

Describe some of the strengths and weaknesses of your analysis (i.e., specific measures, etc.). Also, what other considerations might influence your recommendation?

One consistent advantage is that we come to the same conclusion no matter which method was put to use. Whether or not cash flow was considered (i.e. as it is not for accounting rate of return), the delay in returns for option B was detrimental to the overall return calculations. We did take an assumption for management's required rate of return when calculating net present value.  
  
Where there are potential flaws in the calculations is knowing the lifetime of each option, and how this returns would continue to look past 6 years. Will the high returns continue to increase at an exponential rate for Option B, while the modest returns would stay flat for Option A? Are the high returns in year 6 for option B a high probability of delivering, or is it simply a pipe-dream that has a high ceiling of potential? These are all important factors to consider before finalizing a decision.

Read the response to Part 3 and assign points below. Be sure to see the detailed rubric on the Instructions tab before assigning points.

* 0 pts - 0 points: No answer, completely irrelevant answer.
* 5 pts - 5 points: Insufficient answer, incomplete, lacks supporting evidence.
* 7 pts - 7 points: Passing, meets expectations.
* 9 pts - 9 points: Well above average, exceeds expectations.
* **10 pts - 10 points: Superior performance, excellent.**

Please provide any overall feedback that you have for the author of this assignment. What is one strength of the submission? What is one area of improvement that you would like to suggest?

Submit Review

Excellent !!!

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