1. XYZ Company is considering investing in a project that requires an initial investment of $100,000 for some machinery. There will be net inflows of $20,000 for the first two years, $10,000 in years three and four, and $30,000 in year five. Finally, the machine has a salvage value of $25,000. Calculate the Accounting Rate of Return of the project.

Solution:

Step 1: Calculate Average Annual Profit	
Inflows, Years 1 & 2	
(20,000*2)	$40,000
Inflows, Years 3 & 4	
(10,000*2)	$20,000
Inflow, Year 5	$30,000
Less: Depreciation	
(100,000-25,000)	-$75,000
Total Profit	$15,000
Average Annual Profit	
(15,000/5)	**$3,000**
Step 2: Calculate Average Investment	
Average Investment	
($100,000 + $25,000) / 2 = **$62,500**	
Step 3: Use ARR Formula	
ARR = $3,000/$62,500 = **4.8%**	