36 Investment appraisal (A Level)

Multiple-choice questions

1 Investment appraisal is best described as:

a a method of deciding which bank to invest money in

b a way of assessing whether interest rates are likely to rise or fall in the near future

c a technique for assessing whether a business investment is worthwhile or not

d a method of assessing the qualitative factors involved in a business investment

2 An investment will cost $40,000. It is expected to generate a net cash flow of $10,000 in the first year, $20,000 in the second and $40,000 in the third. What is the payback period?

a two years

b two years and three months

c two years and six months

d three years

Questions **3–6** relate to the following investment information:

An investment will cost $100,000. The expected net cash flows for the four years of the investment's lifespan are shown in the table below.

Year	Net cash flow ($)
1	20,000
2	50,000
3	90,000
4	30,000

3 What is the payback period?

a three years and three months

b two years and three months

c two years and four months

d three years and four months

4 What is the average rate of return?

a 90%

b 22.5%

c 47.5%

d 35%

5 What is the net present value of the project, assuming a discount rate of 7%?

The discount factors are given below:

Year	Discount factor
0	1
1	0.93
2	0.87
3	0.82
4	0.76

a $158,700

b $58,700

c $39,675

d $14,675

6 The net present value of the investment at different discount rates is given in the table below.

Discount rate %	NPV ($)
20	17,940
25	6,368
30	−3,561
35	−12,139

An estimate of the internal rate of return is:

a 28%

b 20%

c 26%

d 30%

7 The residual value of an investment is best described as:

a the initial capital cost

b the forecast net returns of the investment

c the value of the investment at the end of its useful life

d the amount of depreciation charged to an asset during its useful life.

8 Which one of the following is **not** generally regarded as a disadvantage of the payback technique?

a It is difficult to use and understand.

b It ignores how the value of money changes over time.

c It does not assess the profitability of an investment.

d It assumes cash flow is spread evenly across a year.

9 Which one of the following investment-appraisal techniques takes into account the time value of money?

(i) internal rate of return

(ii) average rate of return

(iii) net present value

(iv) payback

a (i) and (ii)

b only (iii)

c (i) and (iii)

d (ii) and (iv)

10 Which one of the following statements is **not** true of net present value as an appraisal technique?

a It takes into account the time value of money.

b It takes the opportunity cost of money into account.

c It avoids the need to choose an actual rate of discount.

d It considers the timing of cash flows.

