**PROJECT APPRAISAL ASSIGNMENT**

**QUESTION ONE**

Gicigi Company Ltd. has been considering the criteria that must be met before a capital expenditure proposal can be included in the capital expenditure programme.

The screening criteria established by management are as follows:

No project should involve a net commitment of funds for more than four years.

Accepted proposals must offer a time adjusted or discounted rate of return at least equal to the estimated cost of capital. Present estimates are that cost of capital as 15 percent per annum after tax.

Accepted proposals should average over the life time, an unadjusted rate of return on assets employed (calculated in the conventional accounting method at least equal to the average rate of return on total assets shown by the statutory financial statements included in the annual report of the company.

A proposal to purchase a new Blocking machine is to be subjected to these initial screening processes. The machine will cost Sh.2,200,000 and has an estimated useful life of five years at the end of which the disposal value will be zero. Sales revenue to be generated by the new machine is estimated as follows:

Year 1 2 3 4 5

Revenue (Sh.’000’) 1,320 1,440 1,560 1,600 1,500

Additional operating costs are estimated to be Sh.700, 000 per annum. Tax rates may be assumed to be 35% payable in the year in which revenue is received. For taxation purpose the machine is to be written off as a fixed annual rate of 20% on cost.

The financial accounting statements issued by the company in recent years shows that profits after tax have averaged 18% on total assets.

**Required**

Present a report which will indicate to management whether or not the proposal to purchase the Blocking machine meets each of the selection criteria. **(20marks)**

**QUESTION TWO**

1. Mumias Milling Company purchased a grinder 3 years ago at a cost of Sh.3.5 million. The grinder had a life of 8 years at the time of purchase. It is being depreciated at 15% per year on a declining balance. The company is considering replacing it with a new grinder costing Sh.7 million with an expected useful life of 5 years.

Due to increased efficiency, the profit before depreciation is expected to increase by Sh.400,000 a year. The old and new grinders will now be depreciated at 25% per year on a declining balance for tax purposes.

The salvage value of the new grinder is estimated at Sh.210,000. The market value of the old grinder, today, is Sh.4 million. It is estimated to have a zero salvage value after 5 years.

The company’s tax is 30% and the after tax cost of capital is 12%.

**Required**

Should the new grinder be bought? Explain (10 marks)