

## *Sunk Costs*



Sunk costs are an amusing concept. Many times we make financial decisions and are not really crunching the numbers. For example, some things are out of our control. If you bought a new car and changed your mind 30 days later, your car may not be worth the same as what you paid for it. These costs are already incurred. There is nothing you can do about. It is a sunk cost. Being aware of this is helpful in many financial decisions on a larger scale! We also learn about outsourcing decisions. This is very relevant to today's world! The cost of outsourcing a function or product production is important. We need to know if it is efficient to do so! Will the quality remain? Will the service remain? And will it be financially viable?

Managerial accounting is done for the purposes of planning, control and

decision making. So even though it is **not** required, we certainly know it's important.

## Capital Expenditures

As our company grows there will times that we will want to expand, purchase equipment and embark on new ventures. There must be great consideration done to justify these large expenses. As we begin to learn how to make these decisions, the topic of finance comes into play.



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### Present Values/ Time Value of Money

The best way to understand this is to imagine someone offered you a dollar today. Now the same person asks if you would rather have that dollar in a year from now. Most of us would take the money now. Not only is it more of a sure thing, we can invest that dollar and earn interest on it. In business decisions, we factor in the time value of money to calculations. Minimum rate of return is decided. This is the least amount that is acceptable to management in going forward with a project. Take note of **Present Values**. This information is also available on some financial calculators and in EXCEL. We conclude with Net Present Value and IRR. NPV is the calculation used in decision making to determine if it is worthwhile to undertake a project or purchase. If the NPV is greater than zero, the manager

will accept the project. IRR (internal rate of return) is the calculation that shows us which interest rate will provide us with a zero net present. The internal rate of return can be compared against a desired rate of return that the managers have determined.

<b><u>Net Present Value (NPV)</u></b>	
$NPV =$	$\sum_{t=1}^T \frac{\text{Cash Flow}_t}{(1+i)^t} - \text{Initial Cash Investment}$
<i>t = Cash Flow Period</i> <i>i = Interest Rate Assumption</i>	

**\*\*Web Site Alert\*\***

Here is a great web site with information about PRESENT VALUE.

[http://www.youtube.com/watch?v=ks33IMoxst0&list=FLRdNV\\_L3nGyG8QdcTYFwKHw&index=62](http://www.youtube.com/watch?v=ks33IMoxst0&list=FLRdNV_L3nGyG8QdcTYFwKHw&index=62)

Debra Touhey, MSA, CFE

### **Reference**

Edmonds, T. O. & Tsay, B. (2010). Survey of Accounting (2<sup>nd</sup> edition). New York: McGraw-Hill Irwin.

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