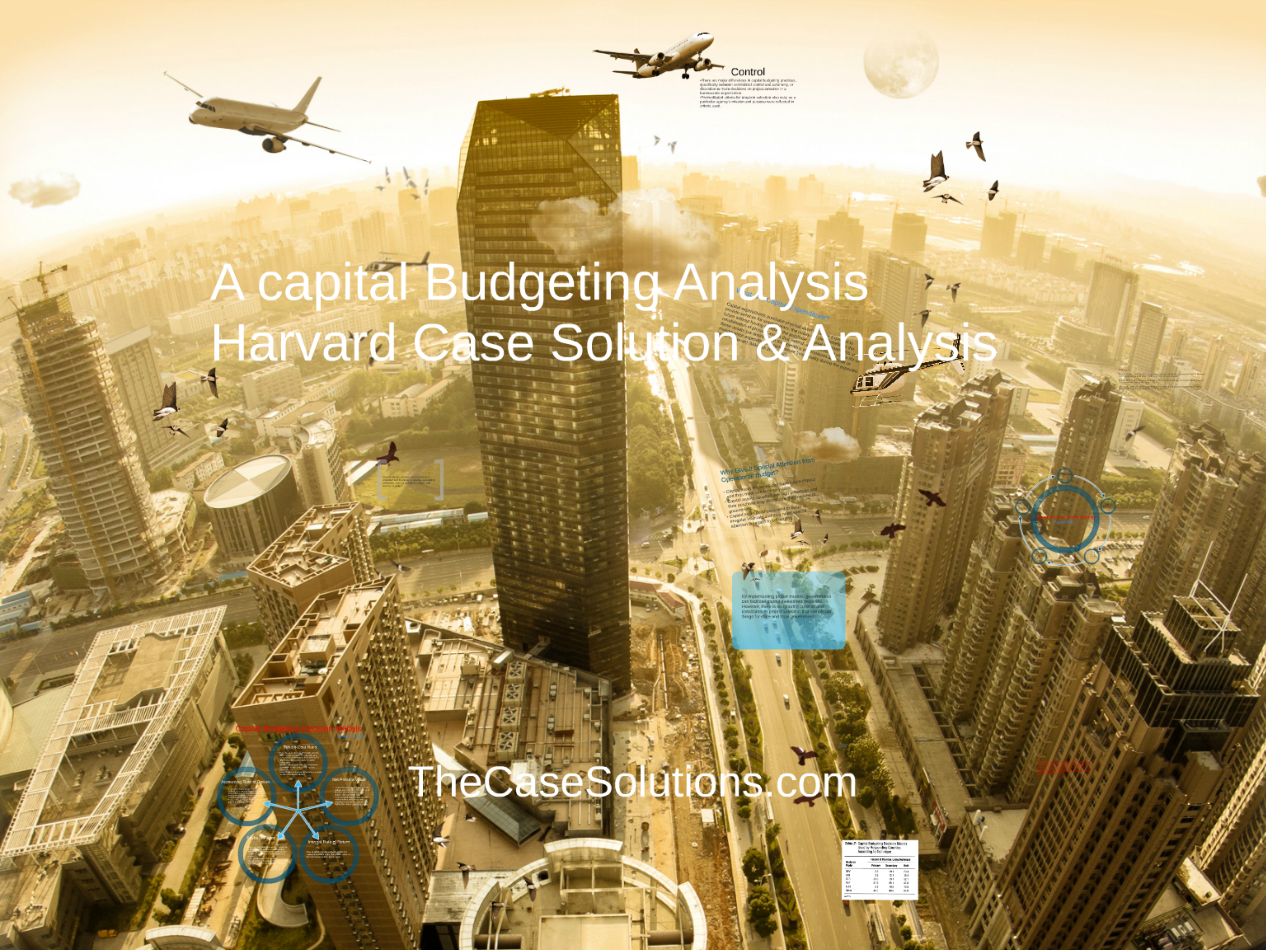
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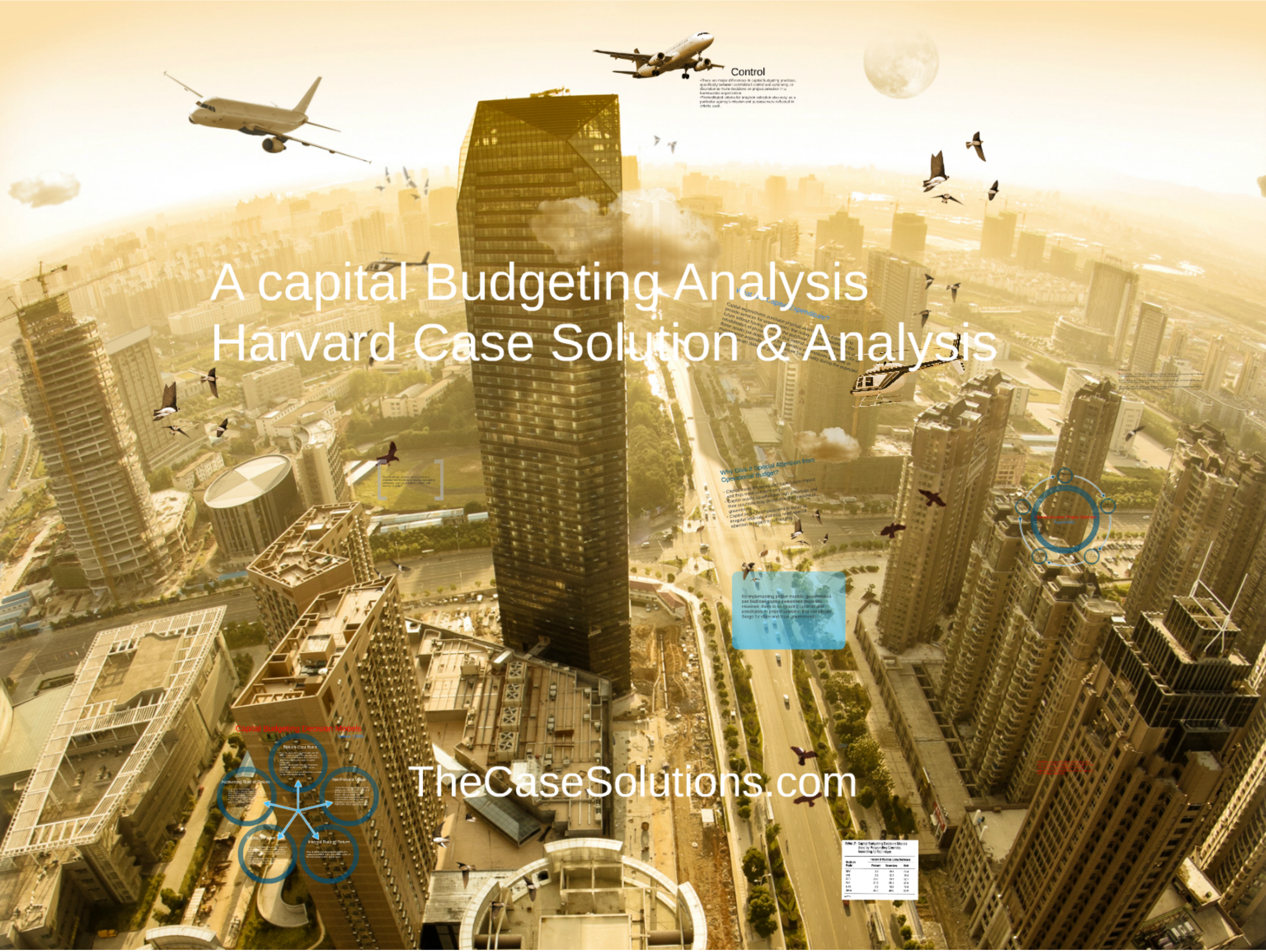
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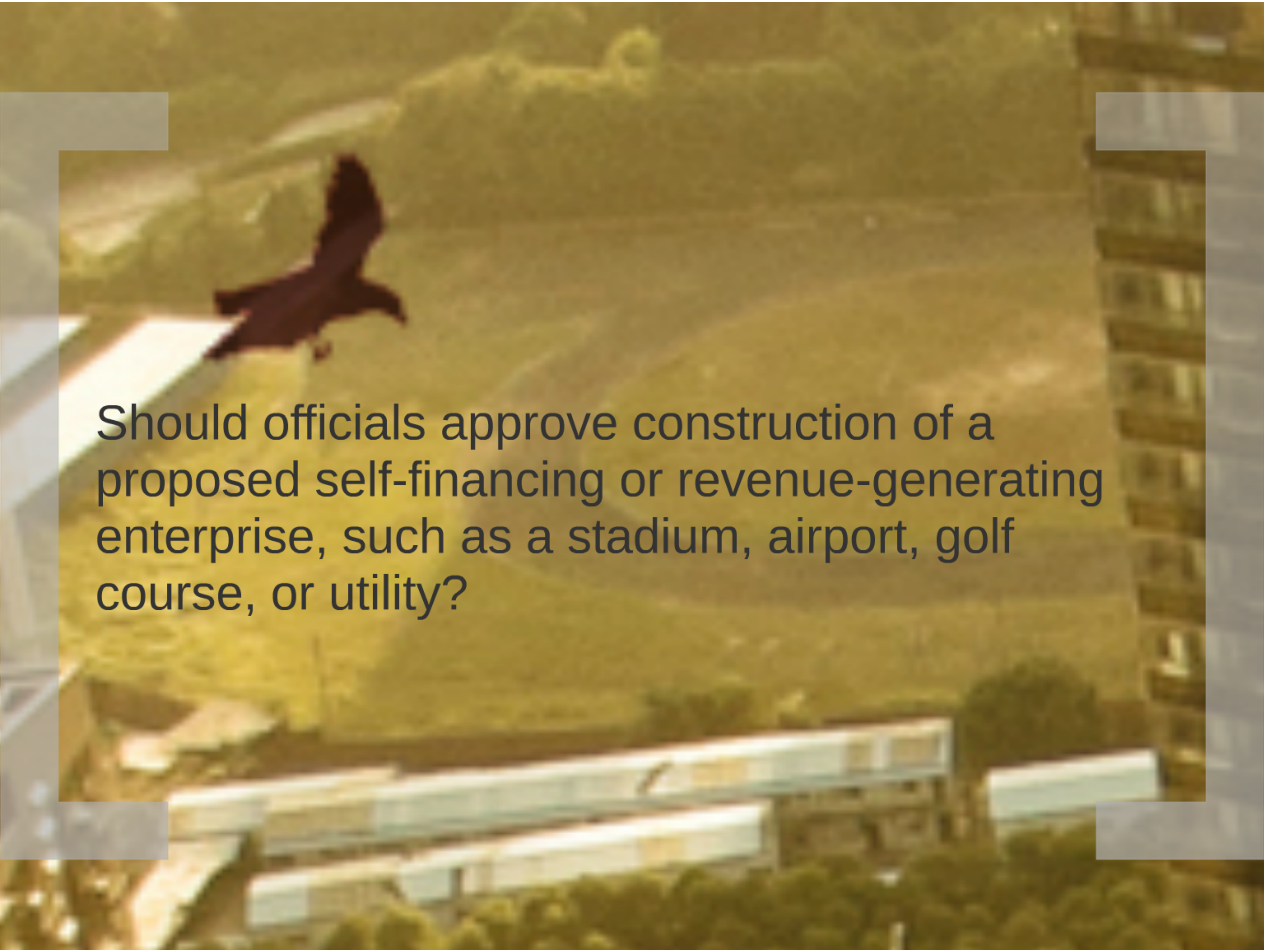
What is a Capital Expenditure?

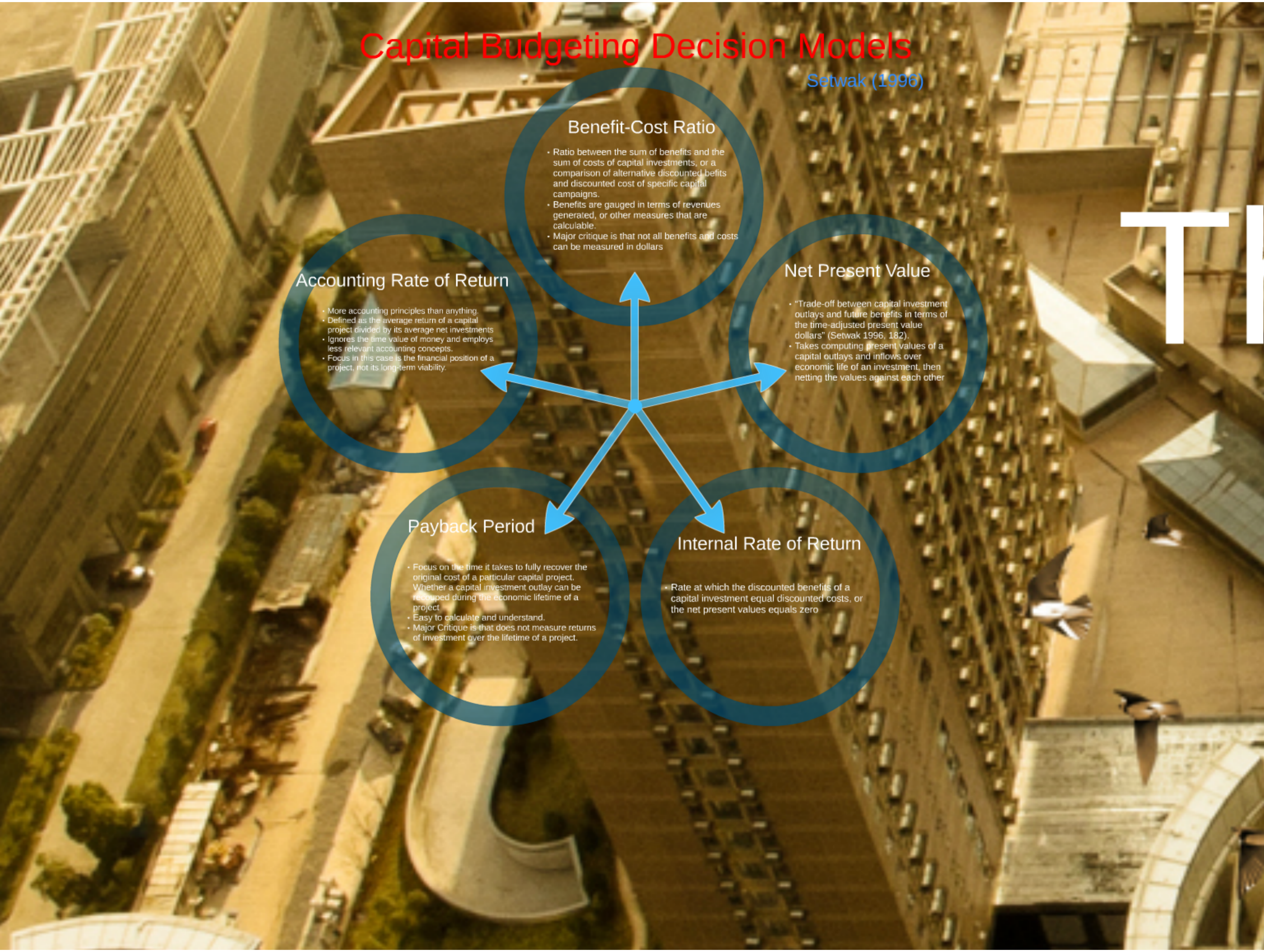
Capital expenditures purchase physical assets that are expected to provide services for several years; the outlay will yield benefits in the future without having to repeat the purchase. Capital improvements or rehabilitation of physical assets that extend or enhance the useful life of these assets (as distinct from the operating expenditures for repair or maintenance expenditures which assure functionality during the expected life of the asset) (Mikesell 20[illegible]38).


Should officials approve construction of a proposed self-financing or revenue-generating enterprise, such as a stadium, airport, golf course, or utility?

Why Give it Special Attention from Operational Budget?

- Capital asset decisions can have future impact and thus merit extraordinary care.
- Capital assets usually have high price tags and their purchase may destabilize the finances of government.
- Capital asset purchases tend to occur at irregular intervals and may need special attention in regard to scheduling.

By implementing proper models, governments can facilitate capital investment decisions. However, there is no ignoring controls and constraints in project selection that complicate things for state and local governments.


Capital Budgeting Decision Models
Setwak (1996)
Benefit-Cost Ratio
• Ratio between the sum of benefits and the sum of costs of capital investments, or a comparison of alternative discounted befits and discounted cost of specific capital campaigns.
• Benefits are gauged in terms of revenues generated, or other measures that are calculable.
• Major critique is that not all benefits and costs can be measured in dollars
Accounting Rate of Return
• More accounting principles than anything.
• Defined as the average return of a capital project divided by its average net investments
• Ignores the time value of money and employs less relevant accounting concepts.
• Focus in this case is the financial position of a project, not its long-term viability.
Net Present Value
• "Trade-off between capital investment outlays and future benefits in terms of the time-adjusted present value dollars" (Setwak 1996, 182).
• Takes computing present values of a capital outlays and inflows over economic life of an investment, then netting the values against each other
Payback Period
• Focus on the time it takes to fully recover the original cost of a particular capital project. Whether a capital investment outlay can be recouped during the economic lifetime of a project
• Easy to calculate and understand.
• Major Critique is that does not measure returns of investment over the lifetime of a project.
Internal Rate of Return
• Rate at which the discounted benefits of a capital investment equal discounted costs, or the net present values equals zero
Th

Capital Budgeting Decision Models

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Accounting Rate of Return

Net Present Value