Session : 2019-20

M.COM.- FIRST YEAR

(II SEMESTER)

CORPORATE FINANCIAL ACCOUNTING

(I-2002)

UNIT – IV : CORPORATE FINANCIAL REPORTING

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LEARNING OBJECTIVES

After you have gone through this unit, you should be able to describe –

- Meaning of Corporate Financial Reporting (***CFR***);
- Types of Corporate Financial Reporting;
- Annual Corporate Report (***ACR***) : Meaning, contents & significance;
- Factors compelling ***CFR***;
- Objectives of ***CFR***;
- Value Added Statement (***VAS***): Meaning, Difference between Value Added & Profit, Advantages & Weaknesses of ***VAS***;
- Gross Value Added (***GVA***) **v/s** Net Value Added (***NVA***)
- Economic Value Added (***EVA***) : Meaning, Components, Benefits and Drawbacks, VA **v/s** EVA;
- Market Value Added (***MVA***);
- Shareholder Value Added (***SVA***).

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SHARE VALUE ADDED (*SVA*)

► It integrates financial statements of the business (***Profit & Loss account, Balance sheet and Cash flow***) into one meaningful measure.

► It is designed to show the amount of **additional earnings** that a company is generating for its investors that is **in excess of its cost of funds**.

FORMULA

SVA = Net Operating Profit **After** Tax (i.e. ***NOPAT***)

(-)

Weighted Average Cost of Capital (i.e. ***WACC***)

► It provides **more relevant information** than the **net profit** figure normally reported by a business, since net profit alone does not take into account the **cost of funds**.

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SHARE VALUE ADDED (*SVA*)

► It is a measure of the **incremental value** of a business to those who have invested in it.

► It represents the **economic profits** generated by a business above and beyond the **minimum return required** by **all** providers of capital.

► **'Value'** is added when the overall net economic cash flow of the business exceeds the economic cost of **all** the capital employed to produce/generate the operating profit.

► It recognizes that **equity holders** as well as **debt financiers** need to be compensated for the bearing of investment risk in government businesses.

SHARE VALUE ADDED (*SVA*)

► It is a highly flexible approach to assist management in decision making process.

► Its applications include -

(i) performance monitoring,

(ii) capital budgeting,

(iii) output pricing and

(iv) market valuation of the entity.

► Its calculation includes **operating profits only**.

► Its measurement should be based on the **last 12 months' performance** on a rolling basis to give the most current results.

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SHARE VALUE ADDED (*SVA*)

► It is a useful concept as it enables both **actual results and forecasts** to be used to assess –

(i) whether value has been added in the past and/or

(ii) whether the financial forecasts and investment decisions will lead to value being added in future.

► If forecasted balance sheet and income statements indicate that value will be diminished, the strategic decisions will of course need to be reviewed.

ECONOMIC VALUE ADDED (*EVA*)

(Devised by mgt. consulting firm Stern Value Management)

1. It is the surplus generated by an entity after meeting an equitable charge towards the providers of capital.

2. It is essentially used to **measure the value** a company generates from funds invested into it -

(i) **Positive Value** means that a company has managed to cover the cost of capital and create additional value.

(ii) **Negative Value** means the company is not generating value from the funds invested into the business and the value of invested capital is being destroyed.

(I) ROUGH APPRAISAL OF *EVA*

(1) BASIC FORMULA

NOPAT

(-)

[INVESTED CAPITAL x WACC]

(2) ADVANCE FORMULA

(In terms of ***Return on Invested Capital***)

RATE OF RETURN

(-)

COST OF CAPITAL

(Contd..)

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(I) ROUGH APPRAISAL OF *EVA*

In other words, **ADVANCE FORMULA** (In terms of ***Return on Invested Capital***) can also be written as follows –

EVA = Invested Capital x (ROIC – WACC)

► Where **ROIC** can be calculated with the help of following formula –

ROIC = NOPAT $(\div)$ INVESTED CAPITAL

or say,

= EBIT (1-Tax Rate) $(\div)$ (Total Assets – Non-Interest bearing Current Liabilities)

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(I) ROUGH APPRAISAL OF *EVA*

NOTES :

1. WACC is the average rate of return a company expects to pay its investors.

2. The weights are derived as a fraction of each financial source in a company's capital structure.

3. Though WACC can be calculated but is normally provided/available as public record.

(3) KEY COMPONENTS OF *EVA* :

(a) NOPAT

(b) AMOUNT OF CAPITAL INVESTED

(c) WACC

Where,

NOPAT* = EBIT (1-Tax Rate)

∴ **EBIT** means **Earnings Before Interest and Taxes.** It is also known as '**Operating Income**'.

(* The figure of NOPAT is normally listed in a public company's financials.)

(I) ROUGH APPRAISAL OF *EVA*

CAPITAL INVESTED =

Total Assets

(-)

Non-Interest bearing Current Liabilities *

[*Accounts Payable, Accruals, Customer Advances *etc*.]

(II) MORE PRECISE APPRAISAL OF *EVA*

► For this, extra adjustments are essentially required.

► Also, accrual based items of the balance sheet must be converted to cash basis items.*

► Finally, adjustment should also be made for off-balance sheet financing.

* An increase in item **'Allowance for doubtful accounts'** does not mean that the company will get less cash, therefore, that amount should be **added back** to get the **true figure** of invested capital.

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USES OF *EVA*

EVA helps to –

1. Measure business performance.
2. Take important managerial decisions.
3. Equate managerial incentives with shareholders' interest, and
4. Improve financial and business literacy throughout the firm.

BENEFITS OF *EVA*

1. It is an index to measure the financial performance.
2. EVA as a performance indicator is very useful.
3. It requires performance above a company's cost of capital.
4. The basic or underlying idea of assessing the performance of a company and its management is that a business is profitable only when it creates wealth and returns for shareholders.
5. It shows how and where a company created wealth, through the inclusion of balance sheet items.
6. It forces managers to be aware of assets and expenses when making managerial decisions.

DRAWBACKS OF *EVA*

1. Its calculation relies heavily on the amount of invested capital.
2. It is best used for asset-rich companies that are stable or mature.
3. Companies with intangible assets, such as technology businesses, may not be good candidates for an EVA evaluation.

CONCLUSION

1. The goal of EVA is to quantify the charge, or cost, of investing capital into a certain project or firm.
2. It then assess whether the project or firm generates enough cash to be considered a good investment.
3. The charge represents the minimum return that investors require to make their investment worthwhile.
4. A positive EVA shows a project is generating returns in excess of the required minimum return.

REFERENCE BOOKS

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2. **International Journal of Accounting and Finance (ISSN online:1752-8232 ISSN print: 1752-8224)**
3. **Shukla S.M. & Gupta K.L., Corporate Financial Accounting (Sahitya Bhawan Publications)**
4. **Gupta K.G., Corporate Financial Accounting (K.G.Publications)**
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6. Maheshwari S.N., Advanced Accounting – Vol.II, (Vikas Publishing House)
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THANKS!