Session : 2019-20 M.COM.- FIRST YEAR (II SEMESTER)

CORPORATE FINANCIAL ACCOUNTING (I-2002)

UNIT – IV : CORPORATE FINANCIAL REPORTING



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).

MARKET VALUE ADDED (MVA)

► It is a difference between the current market value of a company and the capital contributed by all investors.

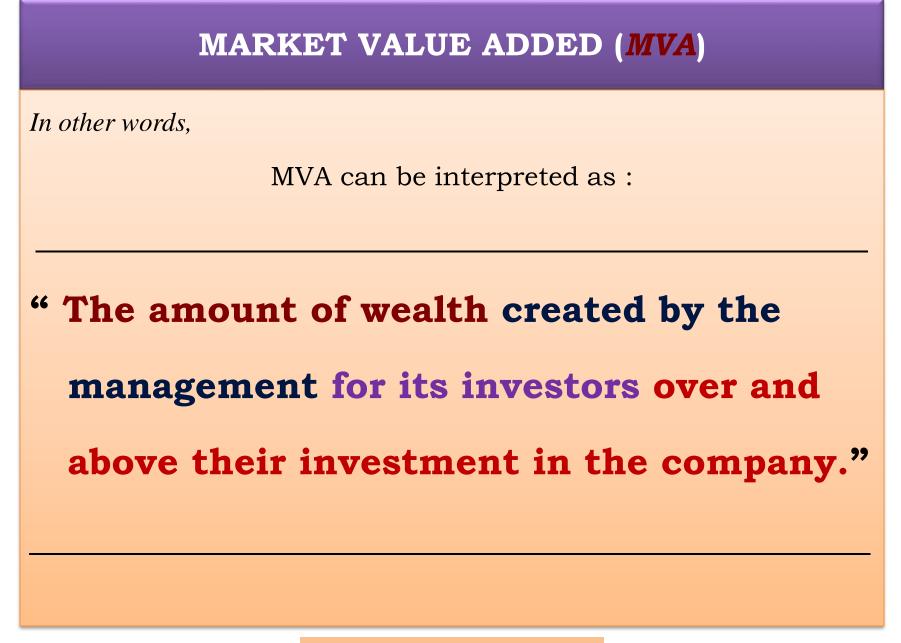
► As MVA represents the NPV of a series of EVA values hence these are said to be closely related.

FORMULA

MVA = Market Value of Capital (-) Capital Invested

► The higher the MVA, the better.

► It is an indication of company's capacity to increase shareholder value over time.





► The aim of the company should be to maximize MVA instead of maximizing the value of the company.

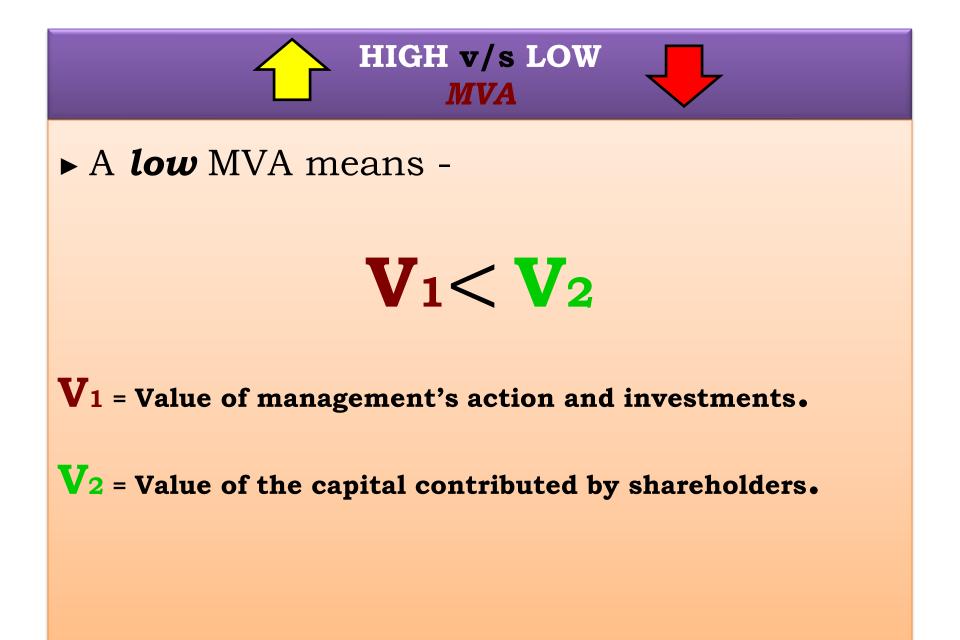
► The reason is that the value of the company can be easily maximized by investing ever-increasing amounts of capital .

► A *high* MVA is an evidence of –

(i) effective management and (ii) strong operational capabilities.

► It indicates that the company has created substantial wealth for its shareholders.





VE MVA

► A **negative** MVA means that the management's actions and investments have diminished and reversed the value of capital contributed by shareholders.

EVA v/s MVA

► The relationship between these two (i.e. EVA & MVA) is more complicated as compared to the relationship between EVA and Firm Value (or say, Market Value of a firm).

Market value of a firm reflects not only the Expected EVA of Assets in place but also the Expected EVA from future projects.
The Market Value can decrease even though the EVA is higher if the

Actual EVA < Expected EVA

EVA v/s MVA

► This does not mean that increasing EVA is bad from a corporate finance point of view. Rather, if a firm is given a choice between –

(i) Delivering a "Below-Expectation" EVA and

(ii) "No" EVA at all

the firm should go with (i) option i.e. it should deliver the "Below-Expectation" EVA b'coz an old saying is that "*Something is better than Nothing*".

► For firms with **high** anticipated growth (and excess returns), the **correlation** between increasing year-to-year EVA and market value will be **weaker**.

► But the result will altogether be different (i.e. correlation will be **stronger**) for firms with **low** or **no** anticipated growth.

BASIS OF DIFFERENCE

- 1. MEANING
- 2. PURPOSE
- 3. FOCUS
- 4. INFORMATION
- 5. TIME VALUE OF MONEY
- 6. COMPUTATION

1. MEANING

• **VA** is the <u>wealth</u> that a firm has been able to create through the collective effort of **CME** (i.e. **C**apital, **M**anagement & **E**mployees)

• **EVA** is the **surplus** generated by an entity after meeting an equitable charge towards the providers of Capital.

2. PURPOSE

- **VA** provides a useful measure in **analysing the performance and activity** of the reporting entity.
- **EVA** is a management tool that helps managers in taking **decisions** which finally increase the shareholders' wealth.

3. FOCUS

• **VA** focuses on the performance of firm and contribution towards **various groups**.

• **EVA** focuses on firm's ability to create surplus above **shareholders' expectations**.

4. INFORMATION

• **VA** reporting is based on the Profit & Loss account information, which is primarily an **internal data**.

• **EVA** reporting uses **market information** and estimates like Cost of Capital, Beta, Risk Free Rate of Return *etc*.

5. <u>TIME VALUE OF MONEY</u>

• **VA** does not recognize time value of money, since it deals with the wealth created by the firm during a specified time period e.g. a financial year.

• **EVA** recognizes time value of money through the use of **WACC** in reporting. The WACC is based on the Present Value (**PV**) of future interest / dividend outflows.

6. <u>COMPUTATION</u>

• VA = Market Price of a Firm's Output

(-)

Cost of Bought in Materials & Services • EVA = NOPAT [i.e. EBIT (1-Tax Rate)] (-) (INVESTED CAPITAL^{*} x WACC)

{* Also known as Capital Employed.}

REFERENCE BOOKS

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THANKS!