**Can someone please provide some assistance with a question. It’s for an MBA course. It needs to be between 600 and 700 words or so. Thank you so much in advance for all your help. I really appreciate it. Please let me know asap if you are unable to help me. The question is……How can Economic Value Added (EVA) statements be used to improve financial statement reporting, results, and success? What are some problems found with EVA?**

**Below is some information to help with assisting me….. I hope it is helpful. The assignment will be submitted to turnitin to check for plagerism, so I have to be sure that nothing is plagerized and everything is in own words.**

Economic Value Added (EVA)

 Economic Value Added (EVA) is a measure of additional value generated over an investment. It is a measure of the financial performance of a project. Since the economic profit also includes all the costs along with the cost of capital, so the concept of EVA is that capital used in business has a cost and if there are earnings more than the cost of capital then a value for shareholders is created. It compares net operating profit of the project with the total cost of capital.

The formula used for calculating EVA is :

(Net investment) x (Actual return on investment – Percentage cost of capital)

How EVA statements can be used:

 Baran et. al (2007) indicated that EVA can be used in finding out explicit features of any output. Its use can be used in making the estimation of the value of the company, in finding out the internal value of the share of the company as well as in solving and simplifying management’s economic interests. In present scenario the use of EVA has increased and its is being used like a financial management system which permits the employees to concentrate highly on the capital used in the business and to generate higher cash flows from it. In this way the business can perform the function of management of its assets and EVA can serve the purpose of holding the organization responsible with respect to each and every economic expenditure that is shown in the financial statements of the company or in the footnotes to the financial statements. Such a position is achieved by EVA because it proposes to prepare the single financial statements which involve the cost of keeping oneself in the business and contrary to it the managers are also made aware of every cent they spend.

EVA statements are helpful in enhancing the reporting of the financial statements, their results and success because EVA focuses on the growth of the organization. The primary focus of every business is to increase the wealth of its investors. It makes necessary for the managers to focus their time in developing the new methods of increasing EVA. The other advantage of EVA is that it facilitates in improving the financial statements of the business and serves as a channel of verbal communication in finalizing long-term decisions. In case if the business has not debts that are outstanding, then its cost of capital is equal to the expected rate of return of the stock of the firm. Therefore, it is important that each project should be evaluated on the basis of its opportunity cost (Brealey, Myers, & Allen (2011).

Problems with EVA

The EVA does not put emphasis on the real options and the growth opportunities that are inbuilt in the decision of investment. It is considered suitable methodology for the companies that have huge assets but fewer or limited growth opportunities. It does not consider the market perspective. It is a costly and time consuming exercise. Higher the assets of the company, higher are the opportunity to generate EVA.

First, EVA or Economic Value Added is the surplus produced by a business after setting aside a fair charge towards the providers of capital. After taxes are paid, the return on capital employed less the cost of capital employed is the Economic Value Added. In practice this means subtracting the cost of capital from the net operating profits after tax. In one sense this is the residual income that accrues to the shareholders after the cost of capital has been removed from the net operating profits after tax. In other words if there is a positive residue, it is good for the shareholders and if there is negative residue it is harmful to the interests of the shareholders.

The normal financial statements do not show this residue, only if the Economic Value Added is calculated can this residue be observed by the shareholders. This residue is also called economic profit. There are several implications of the Economic Value Added. If there is a positive EVA, the firm is performing well and is adding to shareholder value. On the other hand if there is negative EVA it is not good for shareholder value. The Economic Value Added has other implications also. if a business has a positive Economic Value Added then it is likely that in the long run new firms will enter into the industry till the Economic Value Added vanishes because of higher competition. Similarly, in the long run if there is a negative Economic Value Added firms are likely to leave the industry.

Some people feel that the Economic Value Added is an excellent metric. The reasons for this is that if new capital is invested and it earns more than the cost of capital the Economic Value Added will increase. Similarly, if the net operating profits after tax increases without increasing the capital in the firm the Economic Value Added will increases. Finally, if the Economic Value Added is negative, capital may be removed from the business or a part of the business may be divested. Here we also see the problem with Economic Value Added. If new capital is invested and net operating profits after tax also increases, one cannot differentiate the reason for an increase n Economic Value Added. However, by using it as a metric, the Economic Value Added is the only method that connects capital budgeting and strategic investment with post hoc evaluation of performance. What is great about the Economic Value Added is that a forecast can be developed for it. This means that each years' Economic Value Added can become an objective for management.

The Economic Value Added statements help improve the reporting of results because the Economic Value Added of one firm can be compared with those of other firms. These statements compel the managers to sell off projects/ capital where the savings on capital cost is higher than cost of capital, invest in projects where the earnings exceed the cost of capital, and improve profits without further investment in additional capital. So the Economic Value Added statements help exert control over and discipline the management. This kind of control would not have been possible with normal financial statements reporting.

One of the most important uses of Economic Value Added is the evaluation of projects. The cash flow methods that are used from financial accounting has problems that is the cash flow may fluctuate over the life of the project, however, if the Economic Value Added is positive the project may be selected. When profits are calculated using GAAP accounting, the Economic Value Added can be calculated by deducting the opportunity cost of equity.

One of the greatest problems with Economic Value Added is that it is based on accounting profits. if the accounting profits are incorrect or manipulated, the Economic Value Added also gets manipulated. Further, the target setting in the context of Economic Value Added is based on forecasts. if these are incorrect then the entire process of performance evaluation can become faulty. Moreover, if the cost of capital calculations are incorrect the Economic Value Added statement preparation exercise can become meaningless.

Here is a website that has more info on EVA as well…. Hopefully it helps also. <https://shelon64.wordpress.com/2012/05/15/economic-value-added-eva-2/>