

Chapter 2

Financial Statements, Cash Flow, and Taxes

LEARNING OBJECTIVES

After reading this chapter, students should be able to:

- Briefly explain the history of accounting and financial statements, and how financial statements are used.
- List the types of information found in a corporation's annual report.
- Explain what a balance sheet is, the information it provides, and how assets and claims on assets are arranged on a balance sheet.
- Explain what an income statement is and the information it provides.
- Specify the changes reported in a firm's statement of retained earnings.
- Differentiate between net cash flow and accounting profit.
- Identify the purpose of the statement of cash flows, list the factors affecting a firm's cash position that are reflected in this statement, and identify the three categories of activities that are separated out in this statement.
- Discuss how certain modifications to the accounting data are needed and used for corporate decision making and stock valuation purposes. In the process, explain the terms: net operating working capital, total operating capital, NOPAT, free cash flow, and operating cash flow; and explain how each is calculated.
- Define the terms Market Value Added (MVA) and Economic Value Added (EVA), explain how each is calculated, and differentiate between them.
- Explain why financial managers must be concerned with taxation, and list some of the most important elements of the current tax law, such as the differences between the treatment of dividends and interest paid and interest and dividend income received.