Interpreting Financial Statements
Efficiency Ratios

Several ratios exist to help a company assess how efficiently it is operating. The principle efficiency ratios measure the handling of receivables and inventory. Let's look at some of these ratios.

The receivables turnover ratio measures efficiency in collecting receivables by measuring how many times during the year that receivables are generated and then collected.

This is done by comparing sales on credit to the average accounts receivable balance. Average accounts receivable is calculated by adding the AR balance at the beginning of the year to the balance at the end of the year and dividing by two.

If we assume that the year 2007 also began with $30,000 in receivables, and that all their sales are on credit, the receivables turnover ratio for 2007 is 11.67. This number alone is not yet meaningful.

The average receivables amount for 2008 is 30,000 + 125,000 divided by 2, or 77,500. The receivables turnover ratio for 2008 is 3.87.

Receivables Turnover Ratio:
Credit Sales / Avg AR Balance

2007 350,000 / 30,000 = 11.67

2008 300.000 / 77.500 = 3.87

Now we have two years to compare. When the ratio drops like this, it means that sales are producing receivables, not cash. Perhaps collection efforts have diminished this year.

Plum Corporation
Comparative Balance Sheet
as of Dec 31, 2008 and Dec 31, 2007

Assets	2008	2007
Current Assets		
Cash	1,000	10,000
Marketable Securities	0	5,000
Accounts Receivable	125,000	30,000
Inventory	283,480	25,000
Deposits	500	500
Total Current Assets	**409,980**	**70,500**
Fixed Assets		
Land		
Buildin		
Less		

Plum Corporation
STATEMENT OF OPERATIONS
For the years ended 12/31/2008 and 12/31/2007

Revenues	**2008**	**2007**
Sales	300,000	350,000
Less: Returns & Allow	(25,000)	(1,750)
Net Sales	**275,000**	**348,250**