

# 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.

<b>Receivables Turnover Ratio:</b>	
<b>Credit Sales / Avg AR Balance</b>	
<b>2007</b>	<b>350,000 / 30,000 = 11.67</b>
<b>2008</b>	<b>300,000 / 77,500 = 3.87</b>

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.

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		
<b>Assets</b>	2008	2007
<b>Current Assets</b>		
Cash	1,000	10,000
Marketable Securities	0	5,000
Accounts Receivable	125,000	30,000
Inventory	283,480	25,000
Deposits	500	500
<b>Total Current Assets</b>	<b>409,980</b>	<b>70,500</b>
<b>Fixed Assets</b>		
Land		
Buildings		
Less: Accumulated Depreciation		

Plum Corporation STATEMENT OF OPERATIONS For the years ended 12/31/2008 and 12/31/2007		
<b>Revenues</b>	2008	2007
Sales	300,000	350,000
Less: Returns & Allow	(25,000)	(1,750)
<b>Net Sales</b>	<b>275,000</b>	<b>348,250</b>