

ST. MARY'S UNIVERSITY COLLEGE
BUSINESS FACULTY
DEPARTMENT OF ACCOUNTING

**FINANCIAL STATEMENT ANALYSIS: THE
CASE OF ABYSSINIA BANK**

PREPARED BY:

RITA W/GEBRIEL

MARTHA TESFAYE

APRIL 2012
SMUC
ADDIS ABABA

**FINANCIAL STATEMENT ANALYSIS IN THE
CASE OF ABYSSINIA BANK**

**A SENIOR ESSAY SUBMITTED TO THE
DEPARTMENT OF ACCOUNTING
BUSINESS FACULTY
ST. MARY'S UNIVERSITY COLLEGE**

**IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF BACHELOR OF ARTS IN
ACCOUNTING**

BY:

**RITA W/GEBRIEL
MARTHA TESFAYE**

**APRIL 2012
SMUC
ADDIS ABABA**

ST. MARY'S UNIVERSITY COLLEGE

FINANCIAL STATEMENT ANALYSIS IN THE

CASE OF ABYSSINIA BANK

BY:

RITA W/GEBRIEL

MARTHA TESFAYE

FACULTY OF BUSINESS

DEPARTMENT OF ACCOUNTING

APPROVED BY THE COMMITTEE OF EXAMINERS

_____	_____
Department Head	Signature
_____	_____
Advisor	Signature
_____	_____
Internal Examiner	Signature
_____	_____
External Examiner	Signature

ACKNOWLEDGMENTS

The generous cooperation of many people has contributed for the success and completion of this paper, our special gratitude goes to our advisor Dergu Damasie for his commitment on the paper at each stage.

We are very grateful especially to all of our friends for their encouragement and moral support.

We also like to extend thanks to the Bank of Abyssinia specially, the department of finance for availing the necessary information for the study.

Most of all, we thank the lord Jesus Christ for his unfailing love.

Thank you All!!!

TABLE OF CONTENTS

Contents	Pages
Acknowledgments	i
Table of Content	ii
List of Tables	iv
List of Figure	v
Acronyms	vi
CHAPTER ONE: INTRODUCTION	
1.1. Background of the Study	1
1.2. Background of the Organization	2
1.3. Statement of the Problem.....	3
1.4. Research Questions	4
1.5. Objectives of the Study	4
1.5.1. General Objective	4
1.5.2. Specific Objectives.....	4
1.6. Significance of the Study	5
1.7. Scope of the Study.....	5
1.8. Research Design and Methodology.....	5
1.8.1. Type of research	5
1.8.2. Types of Data Used	5
1.8.3. Method of Data Collection	5
1.8.4. Method of Data Analysis.....	6
1.9. Limitation of the Study	6
1.10. Organization of the Study.....	6
CHAPTER TWO: LITERATURE REVIEW	
2.1. Financial Statement	7
2.2. Definition of Financial Statement Analysis	11
2.3. Types of Financial Statement Analysis	12
2.4. Purpose and Objectives of Analyzing Financial Statements .	13
2.5. Problems in financial Statement Analysis.....	15
2.6. Financial Ratio Analysis	18
2.6.1. Nature of Financial Ratio Analysis.....	18

2.6.2. Types of Financial Ratio Analysis	18
2.6.2.1. Liquidity Ratios	19
2.6.2.2. Activity Ratio.....	21
2.6.2.3. Financial Leverage Ratios	22
2.6.2.4. Profitability Ratios.....	23
2.6.2.5. Market Value Ratios.....	24
2.6.3. Standards of Comparison	26
2.6.3.1. Trend Analysis	26
2.6.3.2. Industry Analysis	26
2.6.3.3. Common Size Analysis	27
2.6.4. Use of Financial Ratios Analysis	27
2.6.5. Limitations of Financial Ratio Analysis	28

CHAPTER THREE: DATA PRESENTATION AND ANALYSIS

3.1. Financial Statement Analysis of BOA	29
3.1.1. Liquidity Ratio.....	29
3.1.2. Activity Ratio.....	31
3.1.2.1. Fixed Asset Turnover Ratio (FATOR)	32
3.1.2.2. Total Asset Turnover Ratio (TATOR).....	32
3.1.3. Profitability Ratio	33
3.1.3.1. Net Profit Margin (NPM)	34
3.1.3.2. Basic Earning Power Ratio (BEPR).....	34
3.1.3.3. Return on Total Assets (ROA)	35
3.1.3.4. Return on Equity (ROE).....	36
3.1.4. Coverage Ratio	37
3.1.4.1. Debt to Asset Ratio (DTAR)	37
3.1.4.2. Debt to Equity Ratio (DTER)	38
3.2. Common Size Analysis.....	39
3.3. Common Base year Financial Statement	42

CHAPTER FOUR

SUMMARY OF FINDING, CONCLUSIONS AND RECOMMENDATIONS

4.1. Summary of Finding.....	47
4.2. Conclusions.....	48
4.3. Recommendations	49

BIBLIOGRAPHY

LIST OF TABLES

Titles	Pages
Table 1: Analysis of Current Ratio	30
Table 2: Analysis of Cash Ratio	31
Table 3: Fixed Asset turn over Ratio	32
Table 4: Total Asset turn over Ratio	33
Table 5: Net Profit Margin	34
Table 6: Basic Earning Power Ratio	34
Table 7: Return on Total Asset	35
Table 8: Return on Equity Asset	36
Table 9: Coverage Ratio	37
Table 10: Debt to Asset Ratio	37
Table 11: Debt to Equity Ratio	38
Table 12: Common Size Balance Sheet	40
Table 13: Common Size Income Statement	41
Table 14: Common Base Year Balance Sheet	43
Table 15: Common Base Year Income Statement: Trend	44

List of Figures

Figure 3.1. Liquidity Ratio	31
Figure 3.2. Activity Ratio	33
Figure 3.3. Profitability Ratio	36
Figure 3.4. Coverage Ratio.....	39
Figure 3.5. Trend in Income	45
Figure 3.6. Trend in Expense	46

ACRONYMS

FSA:	Financial Statement Analysis
BOA:	Bank of Abyssinia
NBE:	National Bank of Ethiopia
DSO:	The Days Sales out Standing
FATOR:	Fixed Asset Turn over Ratio
TOTOR:	Total Asset Turn over Ratio
NPM:	Net Profit Margin
BEPR:	Basis Earning Power Ratio
ROA:	Return on Total Assets
ROE:	Return on Equity
EBIT:	Earning before Interest and Taxes
DTAR:	Debt to Asset Ratio
DTER:	Debt to Equity Ratio
CE:	Cash Equivalent
MKT:	Marketable

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Financial analysis means the selection, evaluation and interpretation of financial data along with other pertinent information to assist in investment and decision making. Decision making is one of the most important tasks of every company management, to make this decision every manager need some sort of information, for instance a bank may need financial information about the financial position, performance of the company, the liquidity position and the like to grant a loan (Kieso, Financial Accounting 1992:500)

Financial analysis use for internal and external purpose. For internal purpose such as employee performance, for example, managers are frequently evaluated and compensated on the basis of accounting measures of performance such as profit margin and return on equity. For external purpose financial statement are useful to parties out side the firm including short term and long term creditors and potential investors and evaluate the credit worthiness of borrowers (Kieso, Financial Accounting 1992:501)

Financial statement analysis is a general term used to describe the activity of interpreting and using, as opposed to preparing, financial statements, and primarily accounting data (Kieso, Financial Accounting 1992:501)

In a particular service giving organizations should provide their service efficiently and effectively so as to bring their customer satisfactions to its highest level and safeguard their business. Therefore, financial statement analysis is prepared to predict the amount of expected returns to assess the risks associated with those, returns to improve the firm's

performance. For the purpose, this study will try to make financial statement analysis to identify uses of financial analysis for performance evaluation in Bank of Abyssinia (BOA) (the company's bulletin 2009).

1.2. Background of Bank of Organization

February 15, 1906 marked the beginning of banking in Ethiopia when the first Bank of Abyssinia was inaugurated by Emperor Menelik II. It was a private bank whose shares were sold in Addis Ababa, New York, Paris, London and Vienna. One of the projects financed by the bank in its early years was the Franco-Ethiopia Railway which reached Addis Ababa in 1917.

In 1931, Emperor Haile Selassie introduced reforms into the banking system and the Bank of Abyssinia became the Bank of Ethiopia, a fully government-owned bank providing central and commercial services with the Italian innovation in 1935 came the demise of one of the earliest initiatives in African banking.

On 15 February, 1996, ninety years to the day after the establishment of the first Bank of Abyssinia, a new privately owned bank with this historic name, but otherwise not connected with the older bank, came into existence.

The subscribed capital of the new Bank of Abyssinia (BOA) was Birr 25 Million and its authorized capital Birr 50 Million with 131 shareholders, all Ethiopians.

BOA's key objectives are: - Profitability, efficiency, market share, dynamism, innovation, credibility, competitiveness and courtesy.

In just under three years of operation, BOA is giving evidence that these objectives are being met.

Bank of Abyssinia's Service:

BOA currently offers the following standard service

- Current (checking) accounts
- Saving accounts
- Time deposits
- NR/NT accounts
- Overdraft facilities
- Term loans
- Merchandise loans
- Letters of credit
- Forex bureau services
- Guarantees

In addition to the above

- BOA provides a late after noon services up to 5:00 P.M
- It offers competitive rates to depositors, the most competitive in the industry.
- A customized BOA service offered to our town clients who need to move funds quickly. Funds can be moved through telephone instruction after the customer has gone through an identification procedure.

BOA pays interest every month, not every six months, which is the industry practice. This means that interest is compounded every month.

1.3. Statement of the Problem

Financial statement analysis is crucial for maintaining good judgment on the financial position and future potential and risk associated with it. Investors who purchase a company's stock expect that they will receive dividends and that the stock's value will increase, creditors make loans with the expectation of receiving interest and principal. Both groups bear the risk that they will not receive their expected returns. They use

financial statement analysis to predict the amount of expected returns and assess the risks associated with those returns.

If the financial statement is not analyzed and used efficiently it leads to wrong decision. Due to this reason, users can not evaluate the position of company, efficiency of operations, potential of investments, the credit worthiness of borrowing, etc of a firm.

Therefore, it is important to analyze financial statements of the company in order to determine financial position and performance evaluation.

1.4. Research Questions

The research try to answer the following research question:-

- How was the performance of the Bank for the past three years? (from the year 2007-2009). Hence, this study was undertaken based on the available documents up to the year 2009
- How is the bank in terms of its ability to pay its obligation?
- How is the profitability position of the bank over time?
- What are the financial strength and weakness of the firm?
- Does the firm use it's resource efficiently and effectively?

1.5. Objective of the Study

1.5.1. General Objective

The general objective of the paper is to investigate or review the performance of bank of Abyssinia for the last three years.

1.5.2. Specific Objective

- To assess the ability of the firm to meet it's short term obligation.
- To explore the trends in profitability of the company.
- To assess the firm's financial strength and weakness.

- To look in to how the firm use financial resources efficiently and effectively.

1.6. Significance of the Study

The study of financial statement analysis is important for profit making and not for profit making organization. Since Abyssinia Bank is a profit making organization that gives service in expectation of getting profit and brings their customer satisfactions to its highest level and safeguards their business, this paper is important for the management to evaluate the performance of the firm and help to make decisions based on liquidity ratio and profitability of the company. It also can be used as a reference for further study on the subject.

1.7. Scope of the Study

This study is limited to the analysis of a Bank of Abyssinia financial statement which covers a period from 2007, 2008 and 2009. Under these methods we used ratio, common size and trend for assessing the performance.

1.8. Research Design and Methodology

1.8.1. Types of Research

Descriptive research is this type research employed through quantitative research method.

1.8.2. Types of Data Used

The research has used secondary data sources from various bulletins reports used by the bank regarding its financial performance.

1.8.3. Method of Data Collection

The researcher conducted to get required information on the secondary data which are obtained from the reports.

1.8.4. Method of Data Analysis

Having collected the related documents of the three, years (2007- 2009), from annual report bulletins and other documents, the researchers have identified, collected and coded the financial data and accordingly put them into tables describing year's financial performance by the bank. Having put these financial figures, the researchers have further described it into graphs and ratios. Finally these figures have further explained by words so that the reader could get meaning about the figures and the ratio.

1.9. Limitation of the Study

When conducting this study, there were constraints of time, money and to have access to data necessary for the study. Despite all these facts, the researchers exerted the maximum effort to get valuable and valid data to outshine or reflect the significance of the paper.

1.10. Organization of the Study

This research paper is organized into four chapters. The first chapter is about the introduction part that includes, the back ground of the study, background of organization, statement of the problem, objective of the study, significance of study, scope and limitation of the study and research methodology. Chapter two includes review of related literatures, Chapter three is about data presentation and analysis based on annual report from the company. Chapter four includes summary, conclusion and recommendation.

CHAPTER TWO

LITERATURE REVIEW

2.1. Financial Statements

The end product of the accounting process is a set of financial statements that portrays the company in financial terms. Each relates to a specific date or covers a specific period of business activity, such as a year. Managers and investors want to know about a company's financial statements at the end of the period. Financial statements are intended to enable outsiders to make decisions and to regulate profit distribution. The contents of a business enterprise's financial statements have significant economic consequences on the enterprise, its owners, its creditors and all other parties who have an economic stake in its financial strength and profitability. Financial statements that are relevant, complete, objective, timely and understandable are perceived by users to be credible (Harrison and Horngren, 1998:15)

The published financial statements of a corporation consist of the balance sheet, income statement, statement of cash flows, and accompanying footnotes. A statement of retained earnings is also included with the published financial statements, but it only explains the change in the retained earnings account on the balance sheet. In order to evaluate the financial position of an entity it is necessary to understand these statements and to be aware of their problems and limitations.

1. **Balance Sheet:** A balance sheet, also called statement of financial position, presents the financial position of a business enterprise on a specific date. A balance sheet provides a historical summary of assets, liabilities and equity.

Assets: are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

Liabilities: are probable future sacrifices or economic benefits arising from present obligations or a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

Equity: Is the residual interest in the assets or an entity that remains after deducting its liabilities. In a business enterprise the equity is the ownership interest.

A balance sheet is basically a historical statement because it shows the cumulative effective of past transaction and events. Generally, it is described as a detailed expression of the basic accounting equation.

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

Assets are costs that have not been deducted from revenue; they represent expected future economic benefits. However, the right to assets has been acquired by a business enterprise as a result of past transactions. If no future economic benefit is expected from a cost incurred by the enterprise, the cost in question is not an asset and should not be included in the balance sheet. Liabilities also result from past transactions; they are obligations that require settlement in the future, either by a transfer of assets or by the performance of services. Implicit in these concepts of the nature of assets and liabilities is the meaning of owners' equity as the residual equity in the assets of a business enterprise (Mosich, 1989:167-168)

Equity Capital represents ownership capital as equity shareholders collectively own the company. They enjoy the rewards and bear the risk of ownership. However, their liability, unlike the liability of the owner in a proprietary firm and the partners in a partnership concern is limited to their capital contributions.

Authorized, issued, subscribed, and paid-up capital: the amount of capital that a company can potentially issue, as per its memorandum, represents the authorized capital. The amount offered by the company to the investors is called the issued capital (Chandra, 1997:336)

Debt versus equity: To the extent that a firm borrows money, it usually gives first claim to the firm's cash flow to creditors. Equity holders are only entitled to the residual value, the portion left after creditors are paid. The value of this residual portion is the shareholders' equity in the firm, which is just the value of the firm's assets less the value of the firm's liabilities.

$$\text{Shareholders' equity} = \text{assets} - \text{liabilities}$$

The use of debt in a firm's capital structure is called financial leverage. The more debt a firm has (as a percentage of assets), the greater is its degree financial leverage (Ross, 1998: 23)

Market Value versus Book Value: The values shown on the balance sheet for the firm's assets are book values and generally are not what the assets are actually worth. For current assets market value and book value might be somewhat similar because current assets are bought and converted into cash over a relatively short span of time. In other circumstances, the two values might differ quite a bit. Moreover, for fixed assets, it would be purely a coincidence if the actual market value of an asset (what the asset could be sold for) were equal to its book value. (Ibid)

2. **Income Statement:** An income statement is a summary of revenues and expenses and gains and losses ending with-net income for a particular period of time. The business and investment community uses this report to determine profitability, investment value, and

credit worthiness. It provides investors and creditors with information that helps them predict the amounts, timing and uncertainty of future cash flows. It helps users of financial statements predict future cash flows in a number of different ways. First, investors and creditors can use the information on the income statement to evaluate the past performance of the enterprise. Second, the income statement helps users determine the risk of not achieving particular cash flows.

Revenue is the inflow or other enhancement of assets of a business enterprise or settlements of its liabilities (or a combination of both) during an accounting period from delivering or producing goods, rendering services, or other activities that constitute the enterprise's ongoing major or central operations. Revenue generally results in increase cash and receivables.

Expenses are outflows or other using up of assets or incurrence of liabilities during an accounting period from the sale of goods or the rendering of services.

Income is the residual of revenues which is expenses are deducted.

$$\text{Income} = \text{Revenue} - \text{Expense}$$

3. **Statement of Cash Flows:** The primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an enterprise during a period. To achieve this purpose and to aid investors, creditors, and others in their analysis of cash, the statement of cash flows reports.

1. The cash effects of an enterprise's operations during a period,
2. Its investing transactions.
3. Its financing transactions, and
4. The net increase or decrease in cash during the period.

Reporting the source, uses, and net increase or decrease in cash IS useful because investors, creditors and others want to know what IS happening to a company's most liquid resource. The statement of cash flows is therefore, useful because it provides answers to the following simple but important questions:

1. Where did the cash come from during the period?
2. What was the cash used for during the period?
3. What was the change in the cash balance during the period?

Cash receipts and cash payments during a period are classified in the statement of cash flows into three different activities:

1. **Operating activities:** Involve the cash effects of transactions that enter into the determination of net income.
2. **Investing activities:** Include making and collecting loans and acquiring and disposing of investments (both debt and equity) and property, plant, and equipment.
3. **Financing activities:** Involve liability and owners' equity items and include a) obtaining capital from owners and providing them with a return on (and a return of) their investment and b) borrowing money from creditors and repaying the amounts borrowed (Kieso, 1992: 208-209)

2.2. Definition of Financial Statement Analysis

Financial statement analysis is the process of examining relationships among financial statement elements and making comparisons with relevant information. It is a valuable tool used by investors and creditors, financial analysts, and others in their decision-making processes related to stocks, bonds, and other financial instruments. The goal in analyzing financial statements is to assess past performance and current financial position and to make predications about the future performance of a company (IM Pandey 1982:500)

2.3. Types of Financial Statement Analysis

Primary types of financial statement analysis are commonly known as horizontal analysis, vertical analysis, and ratio analysis (IBID P: 208-209)

Horizontal Analysis

When an analyst compares financial information for two or more years for a single company, the process is referred to as horizontal analysis, since the analyst is reading across the page to compare any single line item, such as sales revenues. In addition to comparing dollar amounts, the analyst computes percentage changes from year to year for all financial statement balances, such as cash and inventory. Alternatively, in comparing financial statements for a number of years, the analyst may prefer to use a variation of horizontal analysis called trend analysis.

Vertical Analysis

When using vertical analysis, the analyst calculates each item on a single financial statement as a percentage of a total. The term vertical analysis applies because each year's figures are listed vertically on a financial statement. The total used by the analyst on the income statement is net sales revenue, while on the balance sheet it is total assets. This approach to financial statement analysis, also known as component percentages, produces common-size financial statements. Common-size balance sheets and income statements can be more easily compared, whether across the years for a single company or across different companies (IBID P: 209)

Ratio Analysis

Ratio analysis enables the analyst to compare items on a single financial statement or to examine the relationships between items on two financial statements. After calculating ratios for each year's financial data, the analyst can then examine trends for the company across years. Since

ratios adjust for size, using this analytical tool facilitates intercompany as well as intra company comparisons (IBID P: 209)

2.4. Purpose and Objectives of Analyzing Financial Statements

A sound analysis of financial statements will be crucial for maintaining good judgment on the financial position and future potential and risk associated with it. Needles and Powers describes the objectives of FSA as broadly as the following:-Creditors and investors as well as managers, use financial statements analysis to judge the past performance and current position of a company, and also to judge its future potential and the risk associated with it. Creditors use the information gained from their analysis to make reliable loans that will be repaid with interest. Investors use the information to make investments that will provide a return that is worth the risk. (Mosich, 1989:445)

- **Past Performance and Current Position:**

Past performance is a good indicator of future performance. Therefore, an investor or creditor looks the trend of past revenues, expenses, net income, cash flow, and return on investment not only as a means for judging management past performance but also as a possible indicator of future performance. In addition, an analysis of current position will tell, for example, what assets the business owns and what liabilities must be paid, It will also tell what the cash position is, how much debt the company has in relation to equity, and what levels of inventories and receivables exist. Knowing a company's past performance and current position is often important in achieving the second general objective of financial analysis.

- **Future Potential and Risk Associated with it:**

Information about the past and present is useful only to the extent that it bears on decisions about the future. An investor judges the potential earning ability of a company because that ability will affect the market price of the company's stock and the amount of dividends the company will pay. A creditor judges the potential debt-paying ability of the company.

The risk of an investment or loan depends on how easy it is to predict future profitability or liquidity.

Financial statement analysis is a judgmental process. One of the primary objectives in identification of major changes (turning points) in trends, amounts, and relationships and investigation of the reasons underlying those changes. Often a turning point may signal an early warning of a significant shift in the future success or failure of the business. The judgment process can be improved by experience and the use of analytical tools.

The interpretation and evaluation of financial statement data require familiarity with the basic tools of financial statement analysis. The accountant's function is twofold:

1. To measure economic events and transactions, and
2. To communicate economic information about them to interested parties.

But communication in accounting means more than just preparing the reports. Communication presumes understanding, and to promote understanding accountants must also analyze and interpret financial statements.

Analysis is used to find answers about the "why" questions in depth. In looking at performance and present position the financial analyst seeks answers to two questions. These are what is the company's earning performance and is the company sound financial condition.

Erich A. Herfet (1991) states three objective of financial analysis

1. **The interpretation of financial information:** It involves judgmental interpretation of the financial statements and other financial data about a company for purposes of assessing and projecting its performance and value.
2. **The use of comparative data:** Are the essential part of financial analysis as they help put judgments about a particular company or business in perspective.
3. **Market analysis:** Involves the study and projection of the pattern of share prices of the company and its competitors relative to the stock market trends.

It is here that financial analysis becomes a bridge between published financial statement reporting accounting performance and market trends reflecting the economic value of a company. The analyst focuses on the value drivers behind the market value of the shares, which are basic economic variables like cash flow generated relative cost effectiveness of the business. (Ibid)

2.5. Problems in Financial Statement Analysis

Some or the problems and limitations of financial statement analysis is discussed below. The problems in conducting a FSA are Development of comparative data, Seasonal/cyclical data distortions, differences in accounting treatment and window dressing.

Developing and Using Comparative Data:- Many large firms operate a number of different division in quite different industries and in such

cases it is difficult to develop meaningful industry averages. This tends to make FSA more useful for small firms with single product lines than for large multi product companies. Additionally most firms want to be better than average (although half will be above and half below the median). So merely attaining average performance is not necessarily good (Harrison and Horngren, 1998: 646)

Seasonal/cyclical data distortions:- inflation has badly distorted firms balance sheets. Further reported profits are affected because past inflation affects both depreciation charges and the cost of inventory include in the cost of good sold. Thus a FSA for one firm over time or a comparative analysis of firms of different ages which use different accounting methods must be interpreted with caution and judgment. (Ibid)

Differences in accounting treatment:- different accounting practices can he distort ratio comparisons. For e.g. there are four commonly used inventory valuation methods: SI, FIFO, LIFO and W A during inflationary periods. LIFO produces a higher CGS and a lower EI valuation than do the other methods of course no problem would occur if firms being compared used the same accounting policies. Fortunately, most firm's in a given industry normally do use similar procedures. Other accounting practices can also create distortions like non capitalized lease.

Window dressing:- Firms sometimes employ window dressing to make their financial statements look better to analysts. If a company record checks received as cash but it record checks written as current liabilities other than as deductions from cash. And also firms may resort to window dressing to project a favorable financial picture. E.g., a firm may prepare its balance sheet at a point when its inventory is very low. As a result it may appear that the firm has a very comfortable liquidity position and a high turnover of inventories. When window dressing of

this kind is suspected, the (Financial Analysis) FA should look the average level of inventory over a period of time and not the level of inventory at just point of time.

Financial statement analysis is limited on several dimensions. GAAP and its underlying accounting conventions and measurement rules and principles, present some limits. Managers often have the ability to select favorable accounting methods. They can make choices as to the timing for reporting favorable or unfavorable results. A close reading of the notes may indicate where some of these choices have had an impact on the financial ratio. However many of these managerial choices will not be revealed to external users of financials statements. Investors, in particular, must rely on independent accounts assessment of the suitability of management's accounting choices.

A second major limitation of financial statement analysis concerns the "what's missing factor. Many major factors affecting profitability and survival of the firm are just not included in accrual accounting not in the financial statement.

A third concern in financial statement analysis that "real" events are often hard to distinguish from the effects of alternative accounting methods or principles. By focusing more on cash flow the investor or other analyst can identify cases where financial reports based on accrual accounting may diverge from the cash flows or inducted reflect other pertinent economic events.

Fourth and final limitation of financial statement analysis concerns predictable. The past may not be a reliable indicator of the future. Stable trends may be reversed tomorrow; financial statements are just one of the important inputs that the investor must use as a basis for investing decisions. (F. Brigham, 1996: 639-641)

2.6. Financial Ratio Analysis

Ratio analysis is the, starting point in developing the information desired by the analyst. Financial ratios are usually expressed in percent or times. These are designed to help one evaluate a financial statement. Financial ratios are ways of comparing and investigating the relationship between different pieces of financial information. Also it shows the financial strengths and weaknesses of the financial performance of a firm. To evaluate a firm's financial condition and performance, the financial analyst needs to perform "checkups" on various aspects of a firm's financial health. (James C-Van Horne, 1998:132)

2.6.1. Nature of Financial Ratio Analysis

Ratio analysis is a powerful tool of financial analysis .A ratio is defined as "the indicated quotient of two mathematical expressions" and as "the relationship between two or more things" In financial analysis, a ratio is used as a benchmark for evaluating the financial position and performance of a firm. For example consider current ratio. It is calculated by dividing current assets by current liabilities: the ratio indicates a quantified relationship between current asset and current liabilities. This relationship is an index or yardstick which permits a qualitative judgment to be formed about the firm's ability to meet its current obligations. It measures the firm's liquidity. The grater the ratio, the grater the firm's liquidity and vice versa. (Pandey, 1996:104)

2.6.2. Types of Financial Ratio Analysis

Generally companies could present comparative or percentage (common size) analysis. In comparative analysis the same information is presented for two or more different dates or periods so that like items may be compared. Absolute figures or ratios are close to being meaningless unless compared to another figure. One must have a guide to determine the meaning of ratios and other measures that are computed. Several

types of comparisons offer insight into the financial position. Using the past history of firms for comparison is trend analysis. By looking at a trend in a particular ratio, one sees whether that ratio is falling, rising, or remaining relatively constant. From this problem is detected or good management is observed. The other comparison is using industry averages and comparison with competitors. The analysis of an entity's financial statements can be more meaningful if the results are compared with industry average and with result of competitors. (Pandey, 1981:502)

Generally, financial ratios are grouped into five categories.

2.6.2.1. Liquidity Ratios

Liquidity Measure of Short-term solvency ratios are intended to provide information about a firm's liquidity. The primary concern is the firm's ability to pay its bills over the short run without undue stress. Consequently, these ratios focus on current assets and current liabilities. Liquidity ratios are particularly interesting to short-term creditors. Because financial managers are constantly working with banks and other short-term lenders, an understanding of these ratios is essential. (Ibid)

One advantage of looking at current assets and liabilities is that their book values and market values are likely to be similar.

There are two commonly used short-term solvency (liquidity) ratios:

1. **The current ratio:** is defined by dividing current assets by current liabilities.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current Liabilities}}$$

Current assets normally include cash, marketable securities, accounts receivable, and inventories. Current liabilities consists of accounts payable, notes payable, current maturities of long term debt, accrued taxes, and other accrued expenses. This ratio tells that the ability of the firm that will be able to cover the liabilities. (Ibid)

2. **The Quick (or Acid-Test) Ratio:** inventory is often the least liquid current asset. It is also the one for which the book values are least reliable as measures of market value, because the quality of the inventory is not considered. The quick ratio could be defined as:

$$\text{Quick, or acid test ratio} = \frac{\text{Current assets} - \text{inventories}}{\text{Current liabilities}}$$

2.6.2.2. Activity Ratio

Activity ratios, also called asset management or turnover ratios, measure how effectively the firm is managing and utilizing its assets. They indicate how much a firm has invested in a particular type of asset relative to the revenue the asset is producing.

These ratios are designed to answer this questions: does the total amount of each type of asset as reported on the balance sheet seem reasonable, too high, or too low in view of current and projected sales levels.

These ratios focus on the sales and the inventory, the fixed assets, days' sale outstanding and the total assets. Ratios included in this category are:

The Inventory Turnover Ratio: shows how rapidly the inventory is turning into receivable through sales. It is described by:

$$\text{Inventory turnover ratio} = \frac{\text{Cost of sold}}{\text{Average inventory}}$$

Average inventory can be computed as: $\frac{\text{Beginning} + \text{Ending Inventories}}{2}$

And also if cost goods sold is not available inventory turnover can be

$$\text{Computed as: Inventory ratio} = \frac{\text{Sales}}{\text{Average inventories}}$$

The Fixed Assets Turnover Ratio: This ratio indicates the extent to which a firm is using existing property, plant and equipment to generate sales. It is the ratio of sales to net fixed assets.

$$\text{Fixed assets turnover ratio} = \frac{\text{Sales}}{\text{Net Fixed Assets}}$$

The Total Assets Turnover Ratio; Measures the turnover of all the firm's assets. It indicates how effectively firm uses its total resources to generate sales and is a summary measure influenced by each of the asset management ratio.

$$\text{Total assets turnover ratio} = \frac{\text{Sales}}{\text{Total Assets}}$$

The Days Sales Outstanding (DSO): Also called the average collection period is used to appraise accounts receivable. It is the average number of days an account receivables remain outstanding. It represents the average length of time that the firm must wait after making a sale before receiving cash, which is the average collection period. (Ibid)

$$\text{DSO} = \frac{\text{Receivables}}{\text{Average sales per day}} = \frac{\text{Receivables}}{\text{Annual Sales} / 360}$$

2.6.2.3. Financial Leverage Ratios

It is also termed as long-term solvency measures or debt management ratios. These ratios are intended to address the firm's long-run ability to meet its obligations, or, more generally, its financial leverage. These ratios are of interest primarily to bondholders who need some indication of the measure of protection available to them. In addition, they indicate

part of the risk involved in investing in common stock. The more debt that is added to the capital structure, the more uncertain in the return on common stock, there are two types of financial leverage ratios: component percentage financial and coverage ratios. Component percentages compare a company's debt with either its total capital (debt plus equity) or its equity capital. Coverage ratio is reflect a company's ability to satisfy fixed obligations such as interest, principal, repayment, lease payments. (Ibid)

Component Percentage Financial Leverage Ratios

The component percentage financial leverage ratios convey how reliant a company is on debt financing. These ratios compare the amount of debt to either the total capital of the company or to the equity capital.

1. **Debt to Total Assets:** The ratio provides the creditors with some idea of the corporation ability to withstand losses without impairing the interests of creditors. From the creditor's point of view a low ratio of debt to total assets is desirable. The lower this ratio is the more 'buffer' there is available to creditors before the corporation becomes insolvent.

$$\text{Debt to total assets} = \frac{\text{Total Debt}}{\text{Total Assets or Equity}}$$

1. **The long term debt to assets ratio:** indicates the proportion of the company's assets that are financed with long term debt.

$$\text{Long term debt asset ratio} = \frac{\text{Total debt}}{\text{Total assets}}$$

2. **The debt to equity ratio:** indicate the relative uses of debt and equity as sources of capital to finance the company's assets evaluated using book value of the capital sources. (Ibid)

$$\text{Total debt to equity ratio} = \frac{\text{Total debt}}{\text{Total shareholders equity}}$$

Coverage Financial Leverage Ratios

In addition to leverage ratio that use information about how debt is related to either assets or, there are a number of financial leverage ratios that capture the ability of the company to satisfy its debt obligations. There are many ratio that accomplish this, but the two most common ratios are the time interest coverage ratio and the fixed charge coverage ratio.

Times interest coverage ratio: Measures how well a company has its interest obligations covered and it is called the interest coverage ratio. This ratio is computed by:

$$\text{Times interest coverage ratio} = \frac{\text{Income before interest and taxes}}{\text{Interest charges}}$$

The fixed charge coverage ratio expands on the obligations covered and can be specified to include any fixed charges, such as lease payments and preferred stock dividends.

$$\text{Fixed charge coverage ratio} = \frac{\text{Earnings before interest and taxes} + \text{lease payment}}{\text{Interest} + \text{lease payment}}$$

Coverage ratios are often used in debt covenants to help protect the creditors.

2.6.2.4. Profitability Ratios

Profitability ratios indicate how well the enterprise has operated during the year. These ratios answer such questions as was the net income adequate? What amount was earned by different equity claimants? Generally, the ratios are either computed on the basis of sales or on an

investment base such as total assets. Profitability is frequently used as the ultimate test of management effectiveness.

Profit Margin on Sales:

Computed by dividing net income by net sales for the period:

Profit margin on sales = for the period.

$$\text{Profit margin on sales} = \frac{\text{Net income}}{\text{Net sales}}$$

Rate of Return on Assets: is a measure of profit per dollar of assets. It is computed by dividing net income by total assets.

$$\text{Rate of Return on Assets} = \frac{\text{Net income}}{\text{Total assets}}$$

Rate of Return on Common Stock Equity: Is a measure of how the stockholders fared during the year. Because benefiting shareholders is the goal of the firm, in accounting sense it is the true bottom line measure of performance.

$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Total Equity}}$$

2.6.2.5. Market Value Ratios

A final group of ratios is based on information not necessarily contained in financial statements, the market price per share of the stock. Obviously, these measures can only be calculated directly for publicly traded companies.

Price/Earnings Ratio: Shows how much investors are willing to pay per dollar of reported profits.

$$\text{Price/Earnings Ratio} = \frac{\text{Market price per share}}{\text{Earnings per share}}$$

Market/Book Ratio: The ratio of a stock's market price to its book value gives another indication of how investors regard the company.

$$\text{Market / Book Ratio} = \frac{\text{Market price per share}}{\text{Book value per share}}$$

Price/Earnings Ratio: shows how much investor is willing to pay per dollar of reported profits.

$$\text{Price/ Earnings Ratio} = \frac{\text{Market price per share}}{\text{Earnings per share}}$$

Market/Book Ratio: The ratio of a stock's market price to its book value gives another indication of how investors regard the company.

$$\text{Market/ Book Ratio} = \frac{\text{Market price per share}}{\text{Book value per share}}$$

Companies with relatively high rates of return on equity generally sell at higher multiples of book value than those with low returns.

Earnings per share: The earnings per share figure is one of the most important ratios used by investment analysis. If no dilute securities are present in the capital structure, then earnings per share is simply computed by dividing net income minus preferred dividends by the average number of shares of outstanding common stock. If, however, convertible securities, stock options, warrants, or other dilute securities are included in the capital structure, earnings per common and common equivalent shares and fully diluted earnings per share figures may have to be used.

$$\text{Earnings per share} = \frac{\text{Net income - preferred dividends}}{\text{Average shares outstanding}}$$

Dilute securities are 'securities that, although they are not common stock inform, enable their holders to obtain common stock upon exercise or conversion (Pandey, 1981:502)

2.6.3. Standards of Comparison

The ratio analysis involves comparison for a useful interpretation of the financial statement. A single ratio in itself does not indicate favorable or unfavorable condition. It should be compared with some standard. Standards of comparison may consist of:

2.6.3.1. Trend Analysis

It is the easiest way to evaluate the performance of a firm is to compare its present ratios with the past ratios. When financial ratios over a period of time are compared, it is known as the trend (or time series) analysis. It gives an indication of the direction of change and reflects whether the firm's financial performance has improved, deteriorated or remained constant over time. The analyst should not simply determine the change but, more importantly, he/she should understand why ratios have changed. The change for example, may be affected by changes in the accounting policies without a material change in the firm's performance.

2.6.3.2. Industry Analysis

To determine the financial condition and performance of a firm, its ratios may be comparing with average ratios of the industry of which the firm is a member. This sort of analysis, known as the industry analysis, helps to ascertain the financial standing and capability of the firm vis-a-vis other firms in the industry. Industry ratios are important standards in view of the fact that each industry has its characteristics which influence the financial and operating relationships (Pandey, 1999: 110-111)

2.6.3.3. Common Size Analysis

Percentage (common size) analysis consists of reducing a series of related amounts to a series of percentages of a given base. All items in an income statement are frequently expressed as a percentage of sales; a balance sheet may be analyzed on the basis of total assets. This analysis facilitates comparison and is helpful in evaluating the relative size of items or the relative change in items. A conversion of absolute dollar amounts to percentages may also facilitate comparison between companies of different size. Common size analysis could be vertical analysis or horizontal analysis (Kieso, 1992: 1361-1362)

2.6.4. Use of Financial Ratios Analysis

Ratio analysis is used by three main groups:

1. Managers who employ ratios to help analyze, control and thus improve their firm's operations.
2. Credit analysts, including bank loan officers and bond rating analysts, who analyze ratios to help ascertain a company's ability to pay its debts;
3. Stock analysts, who are interested in a company's efficiency, risk and growth prospects. Ratio analysis can provide useful information concerning a company's operations and financial condition and it involves the methods of interpreting financial ratios to assess the firm's performance and status. The basic inputs to ratio analysis are the firm's income statements and balance sheet for the periods to be examined (Brigham, 2005:463-464)

2.6.5. Limitations of Financial Ratio Analysis

A ratio can be computed precisely, it is easy to attach a high degree of reliability or significance to it. The reader of financial statements must understand the basic limitations associated with ratio analysis when evaluating an enterprise.

As analytical tools, ratios are attractive because they are simple and convenient. Frequently decisions are based on only these simple computations involving relationships between financial data. The ratios are only as good as the data upon which they are based and the information with which they are compared (Kieso, 1992: 1384-1385)

One important limitation of ratios is that they are based on historical cost, which can lead to distortions in measuring performance. By failing to incorporate changing price information, many believe that inaccurate assessments of the enterprise's financial condition and performance result (Kieso, 1992: 1384-1385)

CHAPTER THREE

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

Under this section the student researchers have gathered the financial data from the different sources of information put in black and white by the bank. Having collected the financial data they have analyzed in view of the literature review depicted in chapter two.

3.1. Financial Statement Analysis of BOA

As we can understand from different fiscal years' annual report, bank of Abyssinia uses different graph and charts contain figures and percentage to compare and contrast year to year trends. Based on this, the researchers use ratio analysis to evaluate the financial performances of different fiscal periods. It is used to interpret the financial statement so that the strength and weakness of a firm as well as its historical performance and current financial condition can be determined. The following financials ratios are computed as follows.

3.1.1. Liquidity Ratio

As the year to year trends indicate that the liquidity position of BOA can say strong, i.e. the liquid asset of the bank in relation to the net current liabilities stood at 43.4% at the end of June, 2007. This is substantially higher than the minimum rate of 15% set by the NBE. Further more, the ratio of capital to risk weighted assets of the bank stood 13.5% (as indicated in Appendix 10) at the end of the fiscal year 2007. As compared to the required minimum capital adequacy ratio of 8% set by the supervisor Authority.

Risk Management Report

Description	2006	2007	2008	2009
Current asset	1,014,059,680	1,339,310,508	1,637,398,474	2,956,238,709
Current liability	2,612,436,106	3,175,212,704	3,849,866,780	4,957,396,033
Current ratio	0.39%	0.42%	0.43%	0.60%

Current Ratio

Current ratio is the ratio of current asset to current liability

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Table 1. Analysis of Current Ratio

Description	2007	2008	2009
Current asset	1,339,310,508	1,637,398,474	2,956,238,709
Current liability	3,175,212,704	3,849,866,780	4,957,396,033
Current ratio	0.42%	0.43%	0.60%

Source: BOA Financial Statement

The above table shows that the bank's current ratio showed slight increase from 2007 to 2008 by 0.01% and also highest increase in 2009 by 0.17%. This indicates that the firm is liquid has the ability to pay bills. On the other hand, a relatively low value of the current ratio in 2007, but this is not considered as an indication that the bank will find difficulty in paying bills because liquidity position of the bank is minimum of 15% Set by the National Bank of Ethiopia.

Cash Ratio

Cash ratio is a ratio of cash equivalent plus marketable security to current liability. It indicate the firm's ability to pay current liability if for some reason immediate payment were demanded.

$$\text{Cash Ratio} = \frac{\text{Cash Equivalent (CE)} + \text{Marketable (MKT) security}}{\text{Current liability}}$$

Table 2. Analysis of Cash Ratio

Description	2007	2008	2009
CE + MKT security	822,003,596	1,442,646,414	2,696,293,802
Current liability	3,175,212,704	3,849,886,780	4,957,396,033
Cash ratio	0.26%	0.37%	0.54%

Source: BOA Financial Statement

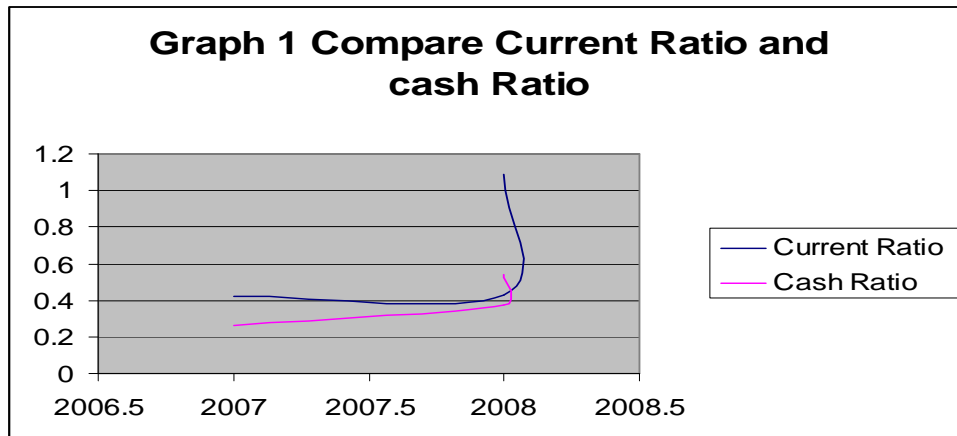


Fig. 3.1. Current and Cash Ratio (Liquidity Ratio)

As the above given table and graph show, the company's cash ratio increased from 2007 up to 2009 at rate of 0.11% and 0.17% respectively. The conventional rule says that the company has cash ratio above standards i.e. 8%. It implies that the liquidity position is strong to satisfy short term obligation by cash. This is because of increase in current liabilities than cash.

3.1.2. Activity Ratios

Activity ratio or asset management ratio indicate the efficiency with which firm manages and used it's asset. The amount of sales generated and the obtaining of the profit depend on the efficient management of this asset by the firm. These activity ratios are also known as "efficiency ratio" because they indicate the speed with which assets being converted or turned over in sales. Ratios that analyze different types of assets are described as follows:

3.1.2.1. Fixed Asset Turnover Ratio (FATOR)

As it was stated in chapter two FATOR indicate the extent of capacity utilization in the firm's properly plant and equipment to generate revenue.

$$\text{FATOR} = \frac{\text{Total Sales}}{\text{Net Fixed Assets}}$$

Table: 3. Fixed Asset Turnover Ratio

Description	2007/08	2008/09	2009/10
Total sales	266,687,844	347,446,002	404,812,945
Net fixed assets	41,311,701	65,971,079	77,639,375
FATOR	6.46%	5.27%	5.21%

Source: BOA Financial Statement

The above table shows that the ratio of sales to fixed assets has decreased with the rate of 1.19% and 0.06% times respectively. A high fixed assets turnover ratio recorded in year 2007. This indicates efficient utilization of fixed assets in sales, while a low ratio in 2009 recorded compared to the previous two years. But the two consecutive years have indicated that there is lag behind in the performance of FATOR. Therefore the firm properly used plant and equipment to generate revenue has been lower through the years indicated.

3.1.2.2. Total Asset Turnover Ratio (TATOR)

TATOR measures the overall performance and efficiency of the business enterprise. It points out the extent of efficiency in the use of assets by the firm.

It is calculated by dividing the annual sales value by the value of total assets.

$$\text{TATOR} = \frac{\text{Total Sales}}{\text{Total Assets}}$$

Table: 4. Total Asset Turnover Ratio

Description	2007	2008	2009
Total Sales	266,687,844	347,446,002	404,812,945
Total Assets	3,577,964,010	4,269,946,935	5,476,625,540
TATO	0.074%	0.081%	0.074%

Source: BOA Financial Statement

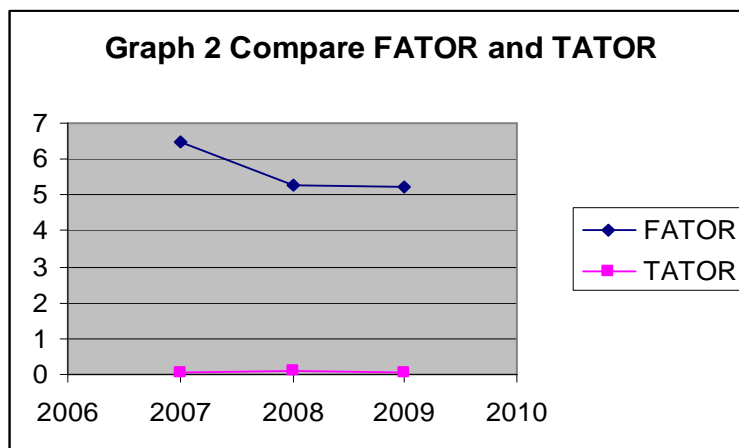


Fig. 3.2. Activity Ratios

The above table and graph show that the company's TATOR ratio has slightly increased from 2007 to 2008 by the rate of 0.007 and in 2009 decreased by 0.007 times. The total asset turnover ratio shows the firm's ability of generating sales from all the financial resources committed to the firm.

As this ratio increases, there is more revenue generated per total investment in assets.

3.1.3. Profitability Ratio

Profitability ratios are calculated to measure the profitability of the firm and operation efficiency. Profitability is the net result of a number of policies and decisions. But the ratios go on to show the combined effects of liquidity, asset management and debt on operating results. Profitability ratios are calculated to measure the profitability of the firm and operation efficiency.

3.1.3.1. Net Profit Margin (NPM)

The first profitability ratio in relation to sales is the net profit margin (simply gross margin). It is calculated by dividing net income by sales.

$$\text{Net Profit Margin} = \frac{\text{Net income}}{\text{Sales}}$$

Table:5 Net Profit Margin

Description	2007	2008	2009
Net income	66,300,800	16,655,459	100,367,944
Sales	266,687,844	347,446,002	404,812,945
NPM	25%	5%	25%

Source: BOA Financial Statement

The analysis implies that the bank's NPM from 2007 to 2008 decreased by 20% as compared to year 2007 and in 2009 increased by 20% as compared to 2008. Where as the least is recorded in 2008 which is 5%, the higher net profit margin is desirable but the banks ratio indicates lower profit margin, which means the bank's management is inefficient in generating income from the sales activity, yet a variety of other factors that are extraneous could be attributed along with this. The net income increase or decrease because of the expense appeared in the year.

3.1.3.2. Basic Earning Power Ratio (BEPR)

It is calculated by dividing earning before interest and taxes (EBIT) to total assets.

$$\text{BEPR} = \frac{\text{EBIT}}{\text{Total Asset}}$$

Table: 6. Basic Earning Power ratio

Description	2007	2008	2009
EBIT	155,471,297	115,310,940	257,466,491
Total Asset	3,577,960,010	4,269,946,935	5,476,625,540
BEPR	4.3%	2.7%	4.7%

Source: BOA Financial Statement

The analysis implies that BEPR slightly decreased from 2007 to 2008 by 1.6% as compared to year 2007/2008. In year 2008 lower percentage recorded because of operating expenses is too large in 2009 increased by 2%. The ratio measures operating income resulting from the bank investment in total asset.

3.1.3.3. Return on Total Assets (ROA)

The ratio of net income to total assets measures the profitability per birr invested in assets. It is computed as the ratio of net income to total assets.

$$\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}}$$

Table: 7. Return on Total Asset

Description	2007	2008	2009
Net income	66,300,800	16,655,459	100,367,944
Total asset	3,577,964,010	4,269,946,935	5,476,625,540
ROA	1.9%	0.4%	1.8%

Source: BOA Financial Statement

The above table shows that the ROA from 2007 to 2008 decreased by 1.5% respectively in 2009 compared to 2008 increased by 1.4%, a lower ROA recorded in 2008 compared to year 2007/2008 this happened because of the occurrence of high expense incurred. The percentage indicates that the bank net profit generated per birr invested in total assets. In 2008 and 2009 profitability of the bank decrease due to inefficient use of its assets. This implies that the bank's performance in this regard in the year has fallen behind as compared to the previous years. Hence, lower ROA has been recorded.

3.1.3.4. Return on Equity (ROE)

Ultimately the most important or “bottom line” accounting ratio is the ratio of net income to shareholder equity (SHE).

$$\text{ROE} = \frac{\text{Net Income}}{\text{Shareholder equity}}$$

Table: 8. Return on Equity

Description	2007	2008	2009
Net income	66,300,800	16,655,459	100,367,944
SHE	404,751,306	420,080,155	519,229,507
ROE	16%	4%	19%

Source: BOA Financial Statement

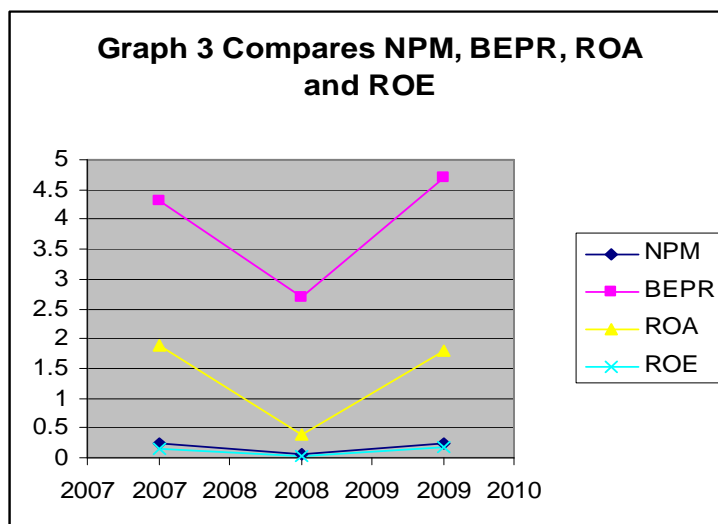


Fig. 3.3. Profitability Ratio

The above table and graph show the ratios declined through the year from 2007 to 2008 decreased by 12% and slightly increased 15% in 2009 compared to year 2007/2009 and also in 2008 drastically decreased to 4% from year 2007/2009. This is a result of increase in capital than net income this implies that the profitable per birr invested by share holder is lower.

3.1.4. Coverage Ratio

The interest coverage ratio is the sum of net profit before interest and tax divided by interest charges.

$$\text{Interest Coverage} = \frac{\text{EBIT}}{\text{Interest Charge}}$$

Table: 9. Coverage Ratio

Description	2007	2008	2009
EBIT	155,471,297	115,310,940	257,466,491
Interest Charge	60,490,965	93,403,514	112,066,716
Interest Coverage	2.57%	1.23%	2.30%

Source: BOA Financial Statement

As shown in the above table, the interest coverage ratio decreased in year 2008 by the rate of 1.34 respectively, in 2009 increase by 1.07, a lower ratios in 2008 indicate excessive use of debt compared to year 2007/2009. The interest coverage ratio shows how many times the interest charges are covered by funds that is ordinarily available to pay the interest charges.

3.1.4.1. Debt to Asset Ratio (DTAR)

The ratio of total debt to total assets is called debt ratio it measures the percentage of funds provided by creditors. It is calculated using the following formula:

$$\text{DTAR} = \frac{\text{Total Debt}}{\text{Total Asset}}$$

Table: 10. Debt to Asset Ratio

Description	2007	2008	2009
Total Debt	3,175,212,704	3,849,866,780	4,957,396,033
Total Asset	3,577,964,010	4,269,946,935	5,476,625,540
DTAR	0.89%	0.90%	0.91%

Source: BOA Financial Statement

Debt ratio shows the proportion of assets that are financed with debt, in all years 2007 to 2009 highest ratio was recorded. This indicates most of bank's capital is financed by debt. The higher ratio means that claims creditors are greater than those of owners. In all years more than 85% of its capital is financed by debt.

3.1.4.2. Debt to Equity Ratio (DTER)

The debt to equity ratio is the measure of the relative claims of creditors and owners against the firm's assets. It is calculated in terms of:

$$\text{DTER} = \frac{\text{Total Debt}}{\text{Shareholder Equity}}$$

Table: 11. Debt to Equity Ratio

Description	2007	2008	2009
Total debt	3,175,212,704	3,849,866,780	4,957,396,033
Share holder Equity	402,751,306	420,080,155	519,229,507
DTER	7.88%	9.16%	9.54%

Source: BOA Financial Statement

The above ratio indicates the relative uses of debt and equity as source of capital to finance the bank assets in 2007 to 2009 increased by the rate of 1.28 and 0.38.

In addition to this the highest debt to equity recorded in 2009. This indicates there is proportional of debt in it's capital high. This is also coverage ratio is shown graphically as follows:

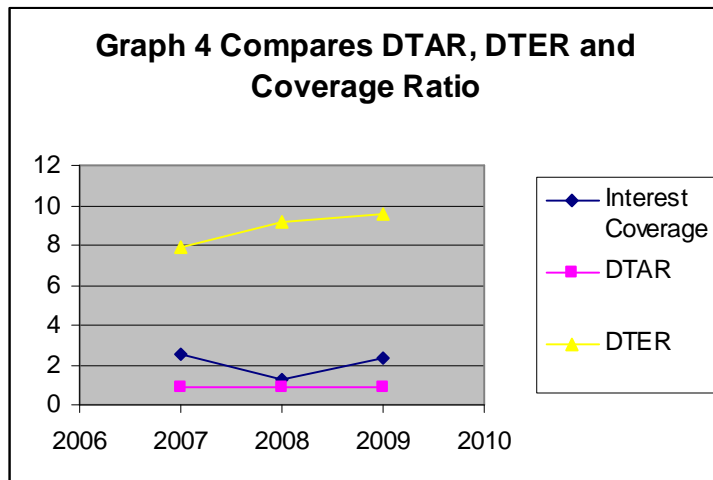


Fig 3.4. Coverage Ratio

3.2. Common Size Analysis

Common size financial statements express each item of the balance sheet and profit and loss statements as a percentage of total assets and total income respectively. Thus, all balance sheet items are divided by total assets and all profit and loss statement items are divided by total income, in this regard, the following table 12 and 13 provide common size financial statements of balance sheet and income statement of BOA.

Table 12: Common Size Balance Sheet (all Numbers in Percentage)

Description	2007	2008	2009
Cash and bank balance			
Cash on hand	3.58	7.62	11.18
Deposit with local commercial bank	0.01	0.03	0.28
Deposit with foreign bank	7.27	6.91	6.85
Reserve account with NBE	3.63	10.42	11.05
Other accounts with NBE	8.47	8.80	19.88
Total cash	23.00	33.80	49.20
Item in course of collection from other bank	3.34	2.34	2.40
Deposits and prepayments	0.24	0.24	0.19
Loans and advances to customer	61.4	60.1	44.6
Treasury bills	5.59	-	-
Other assets	0.20	1.95	2.15
Customer liabilities on letter of creditors per contra	5.08	-	-
Lease hold land	-	0.01	0.01
Deffered expenditures	-	-	0.02
Intangible fixed assets	0.03	-	-
Tangible fixed assets	1.21	1.53	1.39
Total assets	100	100	100
Liabilities deposit	2007	2008	2009
Demand deposits	14.28	18.39	22.12
Saving deposits	53.05	56.47	55.69
Fixed time deposits	8.72	6.58	4.26
Total time deposits	76.05	81.44	82.07
Margin held on letter of credit	0.09	1.80	1.63
Other liabilities	5.84	6.74	6.00
Provision for tax	0.79	0.17	0.82
Banks liabilities of letter of credit per contra	5.08	-	-
Total liabilities	88.73	90.15	90.52
Capital and reserves	-	-	-
Paid up capital	7.41	7.32	5.72
Share premium	-	0.06	0.01
Legal reserve	2.08	1.84	1.90
Special reserve	0.37	0.31	0.47
Retained earnings	1.39	0.29	1.34
Total share holders	11.25	9.82	9.44
Total liabilities and share holders fund	100	100	100

Source: BOA Financial Statement

The above table shows financial statements was a relatively easy to read and compared. Just looking at the three year balance sheet of BOA, in the total assets column the coverage cash compared to other current asset higher which is 23%, 33.8%, 49.2% percentage of total assets respectively in the three year and relatively a lower ratio recorded in the items of deposits and prepayments which is 0.24%, 0.24%, 0.19% percentages of total assets. The liability section recorded a highest ratio in saving deposits recorded above 50% and relatively a lower ratio recorded in the provision for tax which is less than 1% recorded through out the year. Lastly in the equity section recorded. The equity in slightly decrease from 2007 by the rate of 11.25%, 9.82% and 9.44% respectively.

This entails that each year has an increase in current asset and which has its positive intent in the asset side, with lower deposit which indicates the bank didn't perform well in this regard.

Table 13: Common Size Income Statement (all Number In Percentage)

Description	2007	2008	2009
Interest income	75.57	72.65	68.15
Commission income	3.06	3.39	3.31
Provision no longer required	-	-	-
Gain on fluctuation of exchange rates	12.67	15.25	16.94
Service charges foreign and local	5.53	5.54	5.55
Other income	3.16	3.16	6.05
Total revenue	100	100	100
Expense categories	-	-	-
Interest expense	22.68	26.88	27.68
Salaries and benefits	11.90	13.03	16.28
General and administration	11.19	12.28	16.13
Board of directors	1.05	0.07	0.06
Audit fee	0.04	0.03	0.02
Provision for receivables	-	0.31	0.03
Provision for doubtful loans and advances	17.53	41.09	3.86
Total expense	41.70	66.81	36.40

Source: BOA Financial Statement

In the above table the bench mark is sales. For a given period, each item in the income statement is restated as a percentage of sales in the analyses the highest percentage of sales recorded in the revenue section items of interest income which is above 65% and correspondingly in the expense section interest expense is the higher compare to other expense the total expense section higher recorded in 2007 and 2008 which is 42%, 0.67% respectively.

This entails that interest expense has been a driving motive instead of other expenses.

3.3. Common base year financial statement:

Trend analysis standardize financial statement that span several years by selecting base year. Usually, the first year will be taken as a base year. For the analysis of BOA year 2007 is taken as a base year. The following two tables show the trend analysis of income statement and balance sheet of the bank. Then express individual items or accounts as a percentage of the base year value of the item.

Table 14: Common Base year Balance Sheet

Description	2007	2008	2009
Cash and bank balances			
Cash on hand	100	253	477
Deposit with local commercial bank	100	341	364
Deposit with foreign bank	100	113	144
Reserve account with NBE	100	342	465
Other accounts with NBE	100	125	359
Items in course of collecting from other bank	100	84	109
Deposits and prepayment	100	113	115
Loans and advances to customer	100	116	115
Other assets	100	1180	1675
Customers liabilities on letter of credits per contra	100	-	-
Intangible fixed assets	100	-	-
Tangible fixed assets	100	161	187
Total assets	100	119	153
Liabilities			
Demand deposits	100	153	237
Saving deposits	100	127	160
Fixed time deposits	100	90	74
Margin held on letter of credit	100	221	257
Other liabilities	100	137	157
Provision for tax	100	25	158
Bank's liabilities of letter of credit per contra	100	-	-
Total liabilities	100	121	156
Capital and reserves			
Paid up capital	100	117	118
Legal reserve	100	105	139
Special reserve	100	100	193
Retained earnings	100	25	147
Total share holders	100	104	128
Total liabilities and shareholders fund	100	119	153

Source: BOA Financial Statement

In the above table financial statements are relatively read and compared based on the base year to compete how much percent is increased and decreased. We see same item from the balance sheet of the asset section takes, cash on hand increase by 153 percent from 2007 to 2008. Deposit

with local commercial bank increased through out the year specially in the year 2008 and 2009 a highest percent increased by 241% and 364% respectively and also other assets a higher percentage increase in 2008 and 2009. In the liability section all deposits through the three year increase its percentage and other liability account also increase. Lastly in the equity section higher percentage recorded in the legal reserve and paid up capital accounts, a least recorded in the retained earnings accounts specially in year 2008.

Table: 15. Common base year Incomes Statement: Trend

Description	2007	2008	2009
Interest income	100	125	136
Commission income	100	144	163
Gain on fluctuation of exchange rates	100	156	202
Service charges foreign and local	100	130	152
Other income	100	130	290
Total revenue	100	123	141
Expense categories			
Interest expense	100	154	185
Salaries and benefits	100	142	207
General expense	100	142	218
Provision for doubtful loans and advances	100	305	33.45
Total expense Analysis	100	208	132

Source: BOA Financial Statement

Revenue Analysis

The above table compares the percentage change by taking the base year how much increase and decreased the income statement items compared with the base year to the other two year. In the revenue section the interest income of the bank increased throughout the year compared to base year as a percentage of 25% and 36% and also other income increased by 30% and 190% respectively in the year. In the overall income category the BOA registered in 2009 high operating income of birr 404,812 million exhibiting an increase of 17% or birr 57million compare to 2008. This implies the interest income has increased and this has been depicted over the4 entire year and the overall high operating income.

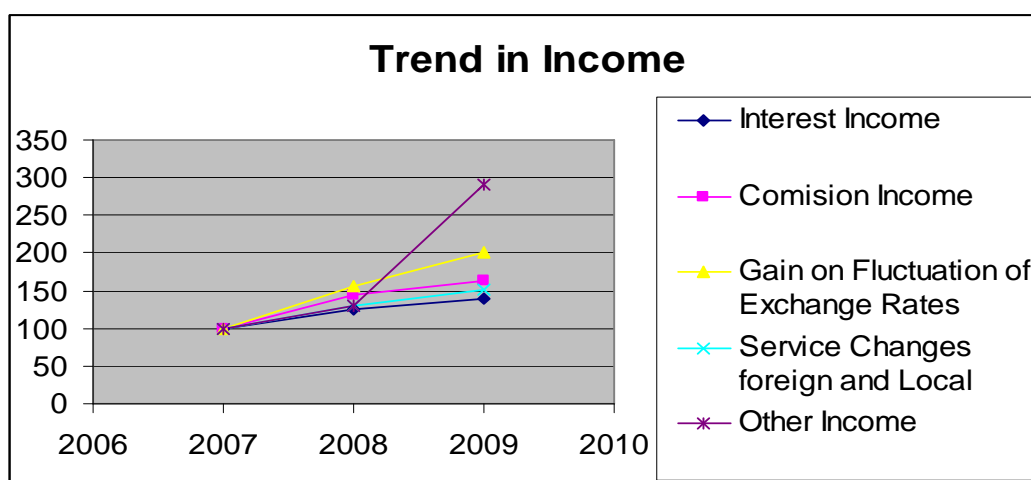


Figure 3.5. Trend in Income

Expense Analysis

In the expense section the interest expense of the bank increase through out the year compare to base year as a percentage of 54% and 85% and also salaries and benefits increased by 42% and 107% respectively in the year. Generally the total expense of the bank in 2009 stood at birr 259.4million this amount compared to 2008 declined by birr 66million

(20%) due to a substantial reduction in the provision for loans and advances for reporting period.

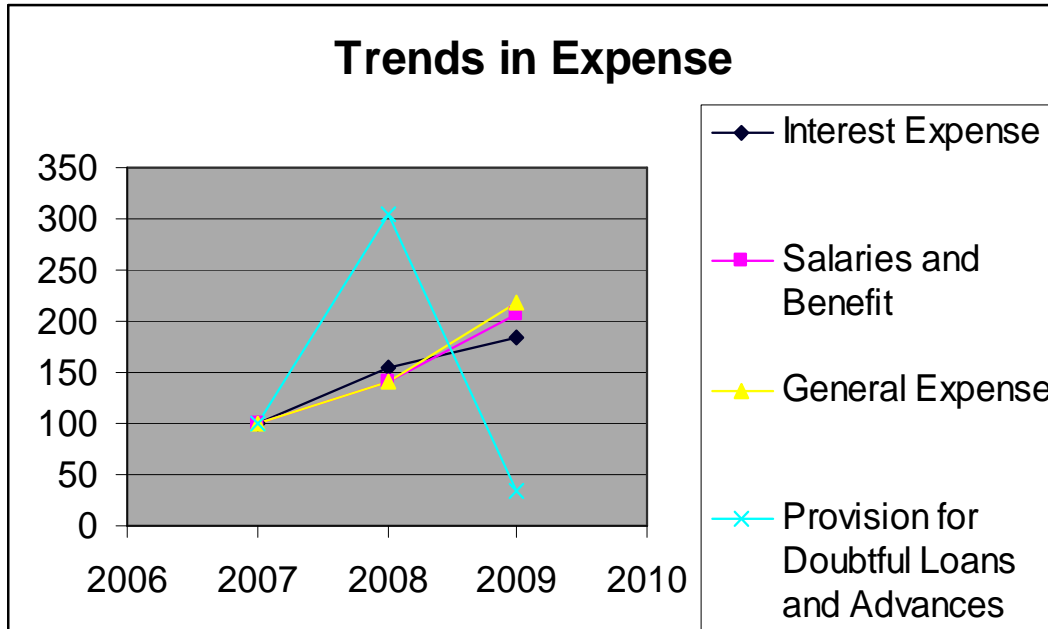


Figure 3.6. Trend in Expense

CHAPTER FOUR

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

In this part the summary of the findings in figures listed above in each section of the measures will be considered and further summarized for convenience and further understanding.

4.1. SUMMARY OF FINDINGS

- The current ratios in the three consecutive years show that an increment above 40%. This indicates that the liquidity position of the bank is strong compared to the minimum requirement of 15% set by the National Bank of Ethiopia (NBE).
- When we observe the operational performances of the bank, more or less it is efficient in using its assets to generate more sales or income, even if, some of its assets are sitting idle.
- The earning power ratio shows a slight decrease from 0.043 to 0.027 in the year 2007 and 2008. Then after, in the fiscal year 2009 it increases to 0.047. In 2008 there was a drastic change in decreasing the basic earning power of the bank due to increasing (boosting) of operating expenses.
- BOA debt ratio shows that the larger part of its capital is financed by debt rather than shareholders equity. i.e. more than 85% of debt financing has been used by the bank in its capital structure.
- Some developments are registered in BOA's income accounts in the year 2008/09 due to a decline in its total expense. In the same fiscal year (2008/2009) the total expense of the bank is declined by 20% from the previous period.

4.2. Conclusions

The researcher has come to conclude the following:-

- The current ratio of the company for most of the research years under the study are shows an increment above 40%. This implies the firm is liquid has the ability to pay bills especially in year 2007 a relatively low value of the current ratio but this is not consider as indication that the bank will find difficulty in paying bills because liquidity position of the bank is minimum of 15% set by the national bank of Ethiopia.
- When we observe the operational performances of the bank, a high fixed assets turn over rations recorded in year 2007. This indicates efficiency in utilizing fixed asset, and a low fixed asset turn over ratio reflects in efficient uses even if, some of its assets are sitting idle. In general we can conclude that the company is utilizing its fixed asset efficiently.
- The earning power ration shows a slight decrease from the year 2007 to 2008. This implies operating expense is too large. In 2008, there was a drastic change in decreasing the basic power of the bank due to increasing operating expense. Then after in the fiscal year 2009 it increases by 2%. This implies basic early power ratio is in a good condition.
- The debt ratios of the company for the three consecutive years are greater than 85%. This shows the firm dominated by the out siders fund and displays its weak financial contribution by the share holder. This shows the contribution of out side debt is highly greater than that of owner's contributions.
- The profitability of the bank increases from year to year, even if there are same fluctuations in the area of utilization of some company's assets and equities. This implies the company is in a positive progress interms of profit.

Recommendations

The researchers listed some suggestions or recommendations for the company based on the researcher's findings and conclusions.

- One of the most important issues that needs a due attention is the claim of creditors is greater than owners. This means BOA debt ratio shows that the larger amount of its assets are financed by debt. In short, debt financing is greater than equity financing. So the company should minimize its debt and rely on self-financing.
- When we observe the distribution of the bank's loans and advances by different economic sectors, it denotes that the domestic trade and services took the lion's share by contributing 28% of the total loan portfolio, but it gives less attention to the agriculture sector. Which is 4% in the fiscal year 2008/2009? But as we know, agriculture is the backbone of the national economy, hence, BOA should create better loan or credit opportunities to those who invest in the agriculture sector.
- The other important issue that needs much concentration is the use of technology. If the bank uses our currently updated technologies such as a payment card system, developing its own software in large, it can register better achievement or results than the previous periods (years).
- The management should also give the emphasis to its profitability. It may work towards enhancing profitability by reducing costs and expenses.
- In addition, the company has a potential to generate income by using the same fixed asset and administrative expense, so it should increase its income by making other businesses.

BIBLIOGRAPHY

- Chandra, Prasanna, (1997). **Financial Management**. 4th ed. Tata McGraw-Hin Publishing Company.
- F. Brigham, (1996). **Intermediate Financial Management**. 5th ed, Tata McGraw-Hin Publishing Company
- Harrison and Horngren, (1998). **Financial Accounting**. 3rd ed. John Wiley and Sons, Inc. New York.
- IM Pandey, (1999). **Financial Management**. 8th ed. New Delhi, Tata McGraw-Hill Company.
- Kieson, (1992). **Financial Accounting**. John wiley and Sons, Inc. New York.
- Mosich, A.N. (1989). **Intermediate Accounting**. 5th ed. McGraw-Hill Book company.
- Ross, Wester Frieid, Jordan, (1998). **Fundamentals of Corporate Finance**. 3rd ed. Tata McGraw-Hill Company Limited of west Pate Nagar, New Delhi.
- Van Harne, Wachowicz, Fr. (1998). **Fundamentals of Financial Management**. India (Manufactured) only in India.

DECLARATION

We, the undersigned, declare that this senior essay is our original work, prepared under the guidance of our advisor. All sources of materials used to the manuscript have been duly acknowledged.

Name: _____

Name: _____

Signature: _____

Signature: _____

Place of Submission: _____

Date of Submission: _____

SUBMISSION APPROVAL SHEET

This senior essay has been submitted for examination with my approval as an advisor.

Name: _____

Signature: _____

Date: _____