Tutorial 3 (Week 4) : Financial Ratios

(a) Identify a current asset account that might require adjustment before annual financial statements can be prepared. What would the effect on the consolidated income statement be if this asset account was not adjusted?

Current Asset Account	Adjustment Type	Effect on IS (if no adjustment made)
Trade Receivables	Accrued Revenues Bad Debt Allowance	Revenues understated, NI understated Expense understated, NI overstated
Inventories	COGS	Expense understated, NI overstated
Other Receivables - Prepayments	Expense	Expense understated, NI overstated

(b) Identify a current liability account that might require adjustment before annual financial statements can be prepared. What would the effect on the consolidated income statement be if this liability account was not adjusted?

Current Liability Account	Adjustment Type	Effect on IS (if no adjustment made)
Trade Payables	Expense	Expense understated, NI overstated
Other Payables - Accruals	Expense	Expense understated, NI overstated
Other Payables - Deferred Income (Unearned Rev)	Revenue	Revenues understated, NI understated
Provision	Expense	Expense understated, NI overstated

(c) Calculate the following financial ratios of SBS Transit for the year 2024 ***and*** 2023: (round your answers to 3 decimal places)

i. Net Profit Margin
ii. Return on Assets (ROA)
iii. Debt Ratio

	2024	**2023**
Net Income	70,301	69,076
Revenues (Turnover)	1,559,728	1,527,136
(i) Net Profit Margin	**4.507%**	**4.523%**
Total Assets	1,160,668	1,172,196
Average Total Assets	1,166,432	1,191,695
(ii) ROA	**6.027%**	**5.796%**
Total Liabilities	441,194	490,112
(iii) Debt Ratio	**0.380**	**0.418**

(d) Based on the three ratios calculated in part (b) above, what do you think about SBS Transit's performance in 2024 as compared to 2023 in terms of its profitability and leverage?

Profitability: Net Profit Margin is similar in both years at around 4.5%, with a minor dip of 0.016% in 2024, suggesting that profitability relative to revenue has not changed significantly. ROA improved slightly from 5.796% to 6.027%, indicating marginally better returns generated from the asset base.

Leverage: The debt ratio declined from 0.418 to 0.380, reflecting a lower reliance on debt financing. This could signal either active deleveraging or an increase in equity relative to liabilities.

As I have emphasized in class, financial ratios are not the end of an analysis but rather the starting point. They should serve as prompts to ask deeper questions and explore the underlying drivers of a company's performance. From these ratios, some questions you might be asking yourselves:

<u>Revenue vs. Costs</u>

- SBS Transit reported strong growth in ridership in 2024. Why did this not translate into higher net profit margins?
- Was operating costs rising faster than revenue?

<u>Asset Efficiency</u>

- ROA increased slightly, does this reflect genuine improvement in asset utilization, or merely a shrinking asset base?
- Since total assets fell in 2024, what specific assets declined?
- How can we verify whether SBS Transit is deploying its assets more efficiently?

<u>Capital Structure</u>

- Was the decrease in debt ratio due to repayment of borrowings, or a rise in equity?
- Does this indicate a deliberate shift in the company's financing strategy or just timing of repayments?
- What are the implications of lower leverage for future growth investments?

~ End of Tutorial 3 Solution ~