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शक्तिउत्थानआश्रमलखीसरायबिहार

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Accounting *Ratios*

Liquidity Ratios

Liquidity ratios are calculated to have indications about the short term solvency of the business, i.e. the firm's ability to meet its current obligations. These are analyzed by looking at the amounts of current assets and current liabilities in the balance sheet. These include bank overdraft, creditors, outstanding capenses, bills payable, income received inadvance. The two ratios included in this category are Current Ratio and Liquid Ratio.

Current Ratio

Current ratio is the proportion of current assets to current liabilities. It is expressed as follows:

$$\text{Current Ratio} = \text{Current Assets} : \text{Current Liabilities or } \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current assets include cash in hand, bank balance, debtors, bills receivable, stock, prepaid expenses, accrued income, and short-term investments (marketable securities).

Current liabilities include creditors, bills payable, outstanding expenses, provision for taxation net of advance tax, bank overdraft, short-term loans, income received in advance, etc.

Illustration 1

Calculate current ratio from the following information:

	Rs.		Rs.
Stock	50,000	Cash	30,000
Debtors	40,000	Creditors	60,000
Bills Receivable	10,000	Bills Payable	40,000
Advance Tax	4,000	Bank Overdraft	4,000

Solution

Current Assets = Rs.50,000 + Rs.40,000 + Rs.10,000 + Rs.4,000 + Rs.30,000
= Rs.1,34,000

Current Liabilities = Rs.60,000 + Rs.40,000 + Rs.4,000 = Rs. 1,04,000

Current Ratio = Rs.1,34,000 : Rs.1,04,000 = 1.29 : 1.

Significance: It provides a measure of degree to which current assets cover current liabilities. The excess of current assets over current liabilities provides a measure of safety margin available against uncertainty in realisation of current assets and flow of funds. The ratio should be reasonable. It should neither be very high or very low. Both the situations have their inherent disadvantages. A very high current ratio implies heavy investment in current assets which is not a good sign as it reflects under utilisation or improper utilisation of resources. A low ratio endangers the business and puts it at risk of facing a situation where it will not be able to pay its short-term debt on time. If this problem persists, it may affect firms credit worthiness adversely. Normally, it is advocated to have this ratio as 2:1.