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Accounting *Ratios*

5.6.2 Quick Ratio

It is the ratio of quick (or liquid) asset to current liabilities. It is expressed as

$$\text{Quick ratio} = \text{Quick Assets} : \text{Current Liabilities} \quad \text{or} \quad \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

The quick assets are defined as those assets which are quickly convertible into cash. While calculating quick assets we exclude the closing stock and prepaid expenses from the current assets. Because of exclusion of non-liquid current asset, it is considered better than current ratio as a measure of liquidity position of the business. It is calculated to serve as a supplementary check on liquidity position of the business and is therefore, also known as 'Acid-Test Ratio'.

Illustration 2

Calculate quick ratio from the information given in illustration 1.

Solution

Quick Assets	= Current Assets - Stock - Advance Tax
Quick Assets	= Rs. 1,34,000 - (Rs. 50,000 + Rs. 4,000) = Rs. 80,000
Current Liabilities	= Rs. 1,04,000
Quick ratio	= Quick Assets : Current Liabilities
	= Rs. 80,000 : Rs. 1,04,000
	= 1:.77

Significance: The ratio provides a measure of the capacity of the business to meet its short-term obligations without any flaw. Normally it is advocated to be safe to have a ratio of 1:1 as unnecessarily low ratio will be very risky and a high ratio suggests unnecessarily deployment of resources in otherwise less profitable short-term investments.

Illustration 3

Calculate 'Liquid Ratio' from the following information:

Current Liabilities	Rs. 50,000
Current Assets	Rs. 80,000
Stock	Rs. 25,000
Prepaid Expenses	Rs. 5,000

Solution

Liquid Assets	=	Current Assets - Closing Stock - Prepaid Expenses
	=	Rs.80,000 - Rs.25,000 - Rs.5,000 = Rs. 50,000
Liquidity Ratio	=	Liquid Assets : Current Liabilities
	=	Rs.50,000 : Rs.50,000 = 1 : 1.