Acid Test Ratio

The acid test ratio, also known as the quick ratio, is a financial ratio used to evaluate a company's short-term liquidity or ability to meet its short-term obligations. It measures a company's ability to pay off its current liabilities with its most liquid assets.

The acid test ratio is calculated by dividing a company's quick assets by its current liabilities. Quick assets include cash, marketable securities, and accounts receivable, while current liabilities include debts due within one year.

The formula for the acid test ratio is as follows:

Acid Test Ratio = (Quick Assets) / (Current Liabilities)

A ratio of 1 or higher is generally considered good, as it indicates that the company has enough quick assets to cover its current liabilities. A ratio of less than 1 indicates that the company may have difficulty meeting its short-term obligations.

The acid test ratio is a more conservative measure of a company's liquidity than the current ratio, as it only includes its most liquid assets. It provides insight into a company's ability to pay off its short-term obligations without relying on the sale of inventory or other less liquid assets.