

CONCEPT: RATIOS – WORKING CAPITAL AND THE CURRENT RATIO

- The concepts of working capital and the current ratio are very similar, so we will study them together
 - The current ratio is the most common _____ ratio

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

Analysis: The current ratio tells us how many dollars of current assets are available for each dollar of current liabilities

Red Flag: A current ratio below _____ is generally a sign of liquidity problems.

- Working capital is not technically a ratio, but still a helpful financial analysis tool

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

Analysis: Positive working capital indicates short-term financial stability.

Red Flag: Negative working capital generally indicates short-term financial problems.
Also, abnormally high working capital could indicate inefficient management of assets.

EXAMPLE: Super Liquid Company has current assets totaling \$450,000 and current liabilities totaling \$315,000. Calculate the current ratio and working capital for SLC.

PRACTICE: The following table contains selected financial information for Tougher Question, Inc.

Cash	\$45,000	Inventory	\$25,000
Machinery	\$80,000	Accounts Payable	\$30,000
Accounts Receivable	\$10,000	Common Stock	\$50,000
Short Term Debt	\$40,000	Bonds Payable	\$100,000
Land	\$60,000	Prepaid Expenses	\$15,000
Accrued Expenses	\$35,000	Retained Earnings	\$20,000

Calculate the current ratio and working capital for TQ, Inc.