# Issue

# Treatment of the Acid-test ratio varies amongst the Services with organizations calculating the ratio differently regarding what is included in the formula’s numerator.

# Research

Below outlines the current treatment of how each service complies and what the regulations, accounting guidance and industry standards are for this area.

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| Acid-Test Ratio Calculation Guidelines | Air Force | Army | Navy | Marines |
| DoDI 1015.10: “MWR installation fund financial results must be at least break-even on an annual basis and must maintain an acid test ratio of at least 1 to 1.”  “Cash plus receivables and/or current liabilities” | Follows Alternative Guidance | Follows Alternative Guidance | Follows Alternative Guidance | Follows Alternative Guidance |
| FMR Volume 13, Chapter 7. 070402. B. Acid-Test Ratio: “The formula to compute the acid-test ratio is to divide quick assets by current liabilities (acid-test ratio = quick assets/current liabilities).”  “The acid-test ratio should not be less than 1:1.” | Follows Alternative Guidance | Follows Guidance | Follows Alternative Guidance | Follows Alternative Guidance |
| AICPA: Current Assets - Inventory/Current Liabilities | Follows Alternative Guidance | Follows Guidance | Follows Alternative Guidance | Follows Alternative Guidance |
| GAAP: Silent on treatment | N/A | N/A | N/A | N/A |
| FASAB Handbook version 12: Silent on treatment | N/A | N/A | N/A | N/A |
| Industry Practice: (Current Assets – Inventory)/Current Liabilities *or* (Cash and Cash Equivalents + Accounts Receivables + Marketable Securities)/Current Liabilities | Follows Alternative Guidance | Follows Guidance | Follows Guidance | Follows Alternative Guidance |

# Discussion

All guidance and regulations indicate that a 1:1 ratio should be maintained in order to cover current debt. As for the actual calculation of the acid-test ratio, some Services define the ratio slightly differently from that standard definitions of (Current Assets – Inventory)/Current Liabilities or (Cash and Cash Equivalents + Accounts Receivables + Marketable Securities)/Current Liabilities. The first definition includes prepaid expenses in the calculation, making it easier to compute but less conservative than the second definition. Additionally, the definition found in the DoDI 1015.10 is unclear. Currently, the DoDI 1015.10 defines the ratio as “Cash plus receivables and/or current liabilities”.

# Working Group Recommendation

Given an industry standard for defining the acid-test ratio as (Cash and Cash Equivalents + Accounts Receivables + Current Marketable Securities)/Current Liabilities, and given the fact that the Services use this definition (or a similar definition) to provide a more conservative measure than (Current Assets – Inventory)/Current Liabilities, it is recommended that the current FMR guidance be altered to define the acid-test ratio as (Cash and Cash Equivalents + Accounts Receivables + Current Marketable Securities)/Current Liabilities. Note, the numerator should include the term “current marketable securities” and not “marketable securities” since the Services have long-term marketable securities which if sold, within 12 months of the balance sheet date, would trigger a penalty on the sale of these securities.

Section 070402.B. of FMR volume 13, Chapter 7 be restated as follows:

Acid-Test Ratio. The acid-test ratio, or quick ratio, measures the ability of NAFIs to use quick assets to liquidate current liabilities. The formula to compute the acid-test ratio is to divide quick assets (cash and cash equivalents + accounts receivables + current marketable securities) by current liabilities (acid-test ratio = quick assets/current liabilities). Quick assets refer to assets that can be easily converted to cash, or that are already in cash form, including cash, receivables, and current marketable securities. Current marketable securities are those that can be sold within 12 months of the balance sheet date and not incur a penalty. Quick assets equal current assets minus inventory and prepaid expenses. The acid-test ratio should not be less than 1:1. A ratio of 1:1 shows that for every dollar of current debt there is $1 of quick assets available to meet current liabilities. Higher ratios indicate NAFIs have sufficient cash and cash equivalents to pay immediate obligations.

It is also recommended that the mentions of acid-test ratio in Enclosures 6 and 7 of the DoDI 1015.10 include references to the definition in FMR volume 13, Chapter 7 and the definition of acid-test ratio in Enclosure 7 be removed.

# Service Concurrence

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| Service | Concurrence | Reason for Non-concurrence |
| Air Force | Emailed concurrence on 6/3/2015. **Re-concurred 10/19/2018.** |  |
| Army | Emailed concurrence on 5/14/2015. **Re-concurred 11/2/2018.** |  |
| Marines | Emailed concurrence on 6/15/2015. **Re-concurred 10/31/2018.** |  |
| Navy | Emailed concurrence on 5/18/2015. **Re-concurred 11/2/2018.** |  |

# USD(C) A&FP Coordination

**Concur** / Non-concur **Comments**:\_\_

1. Regarding the acid-test ratio AICPA calculation I find that my web search (attached) revealed it is (Cash + Cash equivalents + Short-term investments, e.g., marketable securities, + Receivables) ÷ Current liabilities. I checked my Becker and Wiley CPA Review textbooks and they teach the very same.

(a) How did you arrive at "AICPA: Current Assets - Inventory/Current Liabilities"? We used the AICPA - American Institute of Certified Public Accountants: Audit and Accounting Guides and Risk Alerts Archive, Analytical Procedures, Appendix B: Financial Ratios

(b) I concur that the current FMR guidance should be altered to define the acid-test ratio as (Cash and Cash Equivalents + Accounts Receivables + Current Marketable Securities)/Current Liabilities.

(c) You recommended that "the 1:1 acid-test ratio standard found in the DoDI 1015.10 should also be moved to FMR volume 13." Since it is already in FMR Volume13, Chapter 07, paragraph 070403.B., I recommend that DoDI 1015.10 should just reference the FMR. We concur with this approach.

(d) I agree with your re-write of 070403.B. with one exception. I added the following sentence in green font above "Current marketable securities are those that can be sold within 12 months of the balance sheet date and not incur a penalty (see the enclosed decision document)."

# USD(P&R)/MC&FP Disposition

Revise DoDI 1015.10 Enclosures 6 and 7.

**DFAS Disposition**

Revise DoD FMR Section 070402.B. of FMR Volume 13, Chapter 7.

# Forward to DoDIG?

No DoDIG equities.