# MEAC Standard 5 Benchmark B4 requires that schools provide a “current ratio” otherwise known as “Assets to Liability Ratio”.

## What is a current ratio?

**Formula:** Current Assets/Current Liabilities

* Measures a school’s ability to meet its obligations this operating year (only this year).
* It compares a school’s most liquid assets to its short-term liabilities.
* A ratio of greater than 2 to 1 is favorable.
* Anything less than 1:1 is a red flag – essentially they would not have the assets to cover their current liabilities.
* This is only a picture of the current year.
* **EXAMPLE**: 2.51 = org has $2.51 of current assets for every $1 or current liabilities.
* MEAC Standard V, Benchmark B4 requires that the institution maintains a current ratio (assets to liabilities) of at least 1:1. This means the ratio as defined above must be greater than or equal to 1.0.
* For example, if an institution had current assets of $15,000 ($10,000 in a checking account and $5,000 in accounts receivable) and current liabilities of $7,500 (in accounts payable), the current ratio would be 2.0, which meets the benchmark.
* On the other hand, if an institution had current assets of $60,000 and current liabilities of $80,000, the current ratio would be 0.75, which does not meet the benchmark (even though the institution has four times as much money in current assets than in the previous example).
* The intent behind this benchmark is to ensure that an institution has enough money to pay its bills over at least the near term.

## What are current assets and liabilities?

* Assets and liabilities are broken into current and non-current items. Current assets or liabilities are those with an expected life of less than 12 months.
* *Current assets* are expected to be converted to cash or sold or used up, usually within one year or less, through the normal operations of the business.

Examples: The money in the organization's checking account, accounts receivable from students for tuition billed

Counter-examples (i.e. things that are NOT likely to be considered current assets): buildings owned by the organization, office furniture, computer equipment

* *Current liabilities* are liabilities that will be due within a short time (usually one year or less) and that are to be paid out of current assets.

Examples: Accounts payable for routine expenses like payroll, utilities, insurance, the current portion (due within the next year) of any long-term debts

Counter-example: The non-current portion of long term debt such as a mortgage

## Other ratios you may calculate while reviewing a school’s balance sheet:

Acid test ratio

Same as current ratio except that the acid-test ratio *does not* include inventory and prepaids as assets that can be liquidated

Cash ratio

**Formula:** Cash + marketable securities/Current liabilities

* Marketable securities are financial instruments that can be easily converted to cash such as government bonds, common stock or certificates of deposit.
* The cash ratio considers the most liquid element of current assets.
* A ratio of greater than .2 to 1 is favorable.
* **EXAMPLE:** 1.03 = org has $1.03 of its most liquid assets for every $1 of current liabilities

Working Capital Ratio:

**Formula:** Current Assets – Current Liabilities

* Working capital represents operating liquidity available to an organization.
* Positive working capital ensures that a school is able to continue its operations and that it has sufficient funds to satisfy both maturing and short-term debt and upcoming operational expenses.

## Are Title IV schools held to the same tests of financial stability?

The USDE calculates three ratios, each designed to measure a different aspect of financial health:

1. Primary reserve ratio (expendable net assets/total expenses)
2. Equity ratio (modified net assets/modified assets)
3. Net Income ratio (Change in unrestricted net assets/total unrestricted revenue)

These three ratios will then be combined to create a composite score. They are weighted differently to account for the fact that each ratio is not of equal importance.

*Neither the accreditor nor the institution needs to calculate these ratios and the composite score, the USDE will do this based on the institution’s audited financial statements.*

The composite score is designed to reflect the institution’s overall financial health.

* An institution with a composite score of 1.5 or higher is considered financially responsible and is eligible to participate in Title IV programs.
* An institution with a composite score between 1.0 and 1.4 is eligible to participate in the Title IV programs under the “zone alternative”. An institution may remain in the zone for up to three years, but will be subject to additional monitoring requirements. An institution may not stay in this zone for more than three consecutive years.
* An institution with a score of less than 1.0 fails the composite score test and will not be considered financially responsible unless they qualify under one of the alternatives. Generally, an institution would have to provide a letter of credit for 50% of the institution’s prior year Title IV expenditures or accept provisional certification and provide a 10 percent letter of credit to continue to participate in the Tile IV program.