FINANCIAL RATIOS

BASIC LIQUIDITY RATIO

Importance: the basic liquidity ratio reveals the number of months a household could meet current expenses using liquid assets without additional income.

\[
\text{Liquid Assets (from Net Worth Statement)} \div \text{Monthly Expenses (from I and E Statement)} = \text{Basic Liquidity Ratio}
\]

Recommendation: 3.0 or more

DEBT-TO-ASSET RATIO

Importance: measures solvency. If a person owes more than they own, they are insolvent. They would not be able to sell all their assets to pay all their debts.

\[
\text{Total Liabilities (from Net Worth Statement)} \div \text{Total Assets (from Net Worth Statement)} = \text{Debt-to-Asset Ratio}
\]

Recommendation: the further below 1.0 the better. Over 1.0 is insolvent.

DEBT PAYMENT-TO-INCOME RATIO

Importance: shows ability to make current debt payments.

\[
\text{Annual Debt Payments (from I and E Statement)} \div \text{Gross Income (from I and E Statement)} = \text{Debt Payment-to-Income Ratio}
\]

Recommendation: below .36 is adequate, .36 to .41 is marginal, above .41 is risky.