

Personal Finance, 4e (Madura)

Chapter 2 Planning with Personal Financial Statements

2.1 Personal Cash Flow Statement

True or False

1) For most people, the first obstacle is to correctly assess their true net income.

Answer: FALSE

Diff: 2 Page Ref: 24

Question Status: Existing/Old

2) Salary or wages are the only cash inflows for working people.

Answer: FALSE

Diff: 1 Page Ref: 25

Question Status: Existing/Old

3) Cash outflows represent your liabilities such as the pay-off on your car or home.

Answer: FALSE

Diff: 3 Page Ref: 25

Question Status: Existing/Old

4) Net cash flows are the difference between cash inflows and cash outflows and can be either positive or negative.

Answer: TRUE

Diff: 1 Page Ref: 27

Question Status: Existing/Old

Multiple Choice

1) The personal cash flow statement measures

- A) the rate of cash flow.
- B) cash outflows only.
- C) cash inflows and outflows.
- D) cash inflows only.

Answer: C

Diff: 2 Page Ref: 25

Question Status: Existing/Old

2) The cash flow statement reports a person's or family's

- A) net worth.
- B) current income and payments.
- C) plan for borrowing.
- D) value of investments.

Answer: B

Diff: 1 Page Ref: 25

Question Status: Existing/Old

3) Creating a cash flow statement requires that you determine

- A) assets.
- B) liabilities.
- C) cash used for expenses.
- D) market value of investments.

Answer: C

Diff: 2 Page Ref: 25

Question Status: Existing/Old

4) Which of the following is **not** a cash inflow?

- A) Interest received
- B) Dividend income
- C) Car payment
- D) Salary

Answer: C

Diff: 1 Page Ref: 25

Question Status: Existing/Old

5) Jim has \$1,000 income from his job and \$200 stock dividend income this month. This month Jim has rent and utilities of \$300 and he spent \$300 on groceries and \$200 on clothing. What is his cash inflow this month?

- A) \$1,200
- B) \$400
- C) \$600
- D) \$500

Answer: A

Diff: 2 Page Ref: 25

Question Status: Existing/Old

6) Cash outflows are also called

- A) assets.
- B) expenses.
- C) income.
- D) liabilities.

Answer: B

Diff: 1 Page Ref: 25

Question Status: Existing/Old

7) Which of the following is **not** a cash outflow?

- A) Salary
- B) Rent
- C) Telephone bill
- D) Car payment

Answer: A

Diff: 1 Page Ref: 25-26

Question Status: Existing/Old

8) Jeff has a \$1,000 salary and a \$100 dividend income this month. This month Jim has rent and utilities of \$300 and he spent \$200 on groceries and \$100 on clothing. What is his net cash flow this month?

- A) \$400
- B) \$600
- C) \$500
- D) \$1,100

Answer: C

Diff: 2 Page Ref: 26

Question Status: Existing/Old

Short Answer

1) If you prepare a document that shows your cash inflows and cash outflows it is called a(n) _____.

Answer: personal cash flow statement

Page Ref: 25

Question Status: Existing/Old

Matching

Match the following:

- A) measures cash inflows and outflows
- B) summary of assets, liabilities, and net worth
- C) property and land
- D) the difference between cash inflows and outflows
- E) items owned by a household such as a home or car

1) cash flow statement

Question Status: Existing/Old

2) household assets

Question Status: Existing/Old

3) balance sheet

Question Status: Existing/Old

4) net cash flows

Question Status: Existing/Old

5) real estate

Question Status: Existing/Old

Answers: 1) A 2) E 3) B 4) D 5) C

2.2 Factors That Affect Cash Flows

True or False

1) Cash inflows tend to be higher for younger individuals and lower for individuals in their 50s.

Answer: FALSE

Diff: 1 Page Ref: 27

Question Status: Existing/Old

2) Individuals who switch from a low-demand industry to a high-demand industry usually earn higher incomes.

Answer: TRUE

Diff: 1 Page Ref: 27

Question Status: Existing/Old

3) During the final stage in the life cycle, retirement, people experience higher incomes from their demanding careers.

Answer: FALSE

Diff: 1 Page Ref: 27

Question Status: Existing/Old

4) Some people with large incomes spend their entire paychecks within a few days, while others with small incomes may be big savers.

Answer: TRUE

Diff: 2 Page Ref: 28

Question Status: Existing/Old

Multiple Choice

1) Which cash inflow will probably be discontinued after retirement?

A) Dividend and interest received from investments

B) Pension payments

C) Salary

D) Social Security benefits

Answer: C

Diff: 1 Page Ref: 27

Question Status: Existing/Old

2) Which of the following usually affects cash inflows the most?

A) The education and income of your parents

B) Your job skills

C) Your personal consumption behavior

D) The size of your family

Answer: B

Diff: 2 Page Ref: 27

Question Status: Existing/Old

3) Cash inflows tend to be the highest in which of the following?

- A) College
- B) Retirement
- C) 20 years into a career
- D) First job out of college

Answer: C

Diff: 1 Page Ref: 27

Question Status: Existing/Old

4) All of the following affect cash outflows **except**

- A) the size of the family.
- B) your age.
- C) your education level.
- D) your personal consumption behavior.

Answer: C

Diff: 2 Page Ref: 28

Question Status: Existing/Old

5) If both a husband and wife are employed, their consumption behavior will

- A) increase.
- B) decrease.
- C) stay the same.
- D) None of the above; the employment of spouses is unrelated to consumption behavior.

Answer: A

Diff: 1 Page Ref: 28

Question Status: Existing/Old

6) Cash flow can be increased by all of the following **except**

- A) increasing credit card purchases.
- B) working overtime.
- C) selling stock.
- D) getting a second job.

Answer: A

Diff: 1 Page Ref: 27

Question Status: Existing/Old

2.3 Creating a Budget

True or False

1) A personal cash flow statement is usually the starting point for an individual's or family's budget.

Answer: TRUE

Diff: 2 Page Ref: 28

Question Status: Existing/Old

2) One advantage of budgeting several months in advance is that you will be warned of potential deficiencies and can determine how to cover them.

Answer: TRUE

Diff: 1 Page Ref: 30

Question Status: Existing/Old

3) The most common error people make is to underestimate cash inflows and overestimate cash outflows.

Answer: FALSE

Diff: 3 Page Ref: 30

Question Status: Existing/Old

4) Detecting future cash flow overages and deficiencies in cash inflows and outflows improves with practice in the budgeting process.

Answer: TRUE

Diff: 1 Page Ref: 30

Question Status: Existing/Old

5) One of the problems in making a monthly budget is that some expenses fluctuate quite a bit from month to month.

Answer: TRUE

Diff: 1 Page Ref: 30-31

Question Status: Existing/Old

6) A three-month budget is easier to prepare, anticipates large and unusual expenditures, and gives a better picture than a twelve-month budget.

Answer: FALSE

Diff: 2 Page Ref: 31

Question Status: Existing/Old

7) Getting financial help from family and friends is easy and should be one of your first options in case of emergencies.

Answer: FALSE

Diff: 2 Page Ref: 34

Question Status: Existing/Old

8) Careful budgeting and controlled spending lead to self-reliance and a feeling of financial freedom.

Answer: TRUE

Diff: 1 Page Ref: 34

Question Status: Existing/Old

Multiple Choice

1) Many individuals tend to _____ their cash inflows and _____ their outflows.

- A) underestimate; overestimate
- B) overestimate; underestimate
- C) minimize; maximize
- D) not know; accurately know

Answer: B

Diff: 3 Page Ref: 30

Question Status: Existing/Old

2) A budget will **not** do which of the following?

- A) Help determine if cash outflows will be sufficient to cover cash inflows
- B) Anticipate cash shortages
- C) Determine the excess you have to invest
- D) Determine the additional payments you can make to reduce personal debt

Answer: A

Diff: 2 Page Ref: 28-29

Question Status: Existing/Old

3) If you do not budget for unexpected expenses in a given month, you will likely experience a(n)

- A) cash shortage.
- B) cash surplus.
- C) increase in assets.
- D) decrease in liabilities.

Answer: A

Diff: 1 Page Ref: 30

Question Status: Existing/Old

4) In budgeting, it is useful to compare _____ with the budgeted amounts to determine the accuracy or error of the budget and adjust it as necessary.

- A) actual inflows
- B) actual outflows
- C) both actual inflows and outflows
- D) current assets

Answer: C

Diff: 2 Page Ref: 30

Question Status: Existing/Old

5) If spending exceeds the amount of your income over a period of time, your **best** option is probably to

- A) reduce your spending.
- B) sell some of your assets.
- C) increase your work hours.
- D) get a second job.

Answer: A

Diff: 1 Page Ref: 30

Question Status: Existing/Old

6) Which of the following is **not** an appropriate approach to solving the problem of an annual budget deficit?

- A) Liquidate enough savings or investments to make up the deficit
- B) Increase short-term, flexible expenditure items
- C) Renegotiate terms for long-term expense items
- D) Increase income by getting an additional part-time job

Answer: B

Diff: 2 Page Ref: 30

Question Status: Existing/Old

Short Answer

1) A(n) _____ is a forecast of your future cash inflows and outflows.

Answer: budget

Page Ref: 28

Question Status: Existing/Old

Essay

1) Budgeting is a starting point for developing your financial plan. A good understanding of cash inflows and outflows, or what you make and spend is essential. Describe one way to increase your cash inflows and one way to decrease your personal outflows.

Answer: Increase inflows through more income such as a pay increase or another job. To decrease outflows, cut expenses on a variety of personal expenditures. The answer is subjective and there are a variety of acceptable answers in addition to this basic one.

Page Ref: 28-34

Question Status: Existing/Old

2.4 Personal Balance Sheet

True or False

1) Stocks are considered liquid assets since they are easy to sell without a loss in value.

Answer: FALSE

Diff: 2 Page Ref: 35

Question Status: Existing/Old

2) Long-term liabilities are debts that will be paid at least three years into the future.

Answer: FALSE

Diff: 1 Page Ref: 36

Question Status: Existing/Old

3) A high debt ratio indicates an excessive amount of debt and should be reduced over time to avoid any debt repayment problems.

Answer: TRUE

Diff: 2 Page Ref: 40

Question Status: Existing/Old

Multiple Choice

1) Which one of the following is a liquid asset?

A) Cash in a savings account

B) A swimming pool

C) Real estate

D) Stock held in an IRA

Answer: A

Diff: 2 Page Ref: 35

Question Status: Existing/Old

2) Liquid assets refers to

A) the earnings on savings.

B) the ease of converting a financial resource into cash without a loss in value.

C) the amount of insurance coverage a person has.

D) a person's inability to pay his or her debt.

Answer: B

Diff: 2 Page Ref: 35

Question Status: Revised

3) Which of the following would increase your liquid assets?

A) Buying a new car

B) Making regular deposits to a savings account at your bank

C) Buying rental property

D) Putting more of your salary in a 401(k)

Answer: B

Diff: 1 Page Ref: 35

Question Status: Existing/Old

4) Which of the following is **not** a liquid asset?

- A) Cash in your pocket
- B) Money in a savings account
- C) Corporate stock you own outright
- D) Money in your checking account

Answer: C

Diff: 2 Page Ref: 36

Question Status: Existing/Old

5) Which of the following is **not** considered an asset for a family?

- A) Cash in a checking account
- B) A mortgaged home
- C) A leased car
- D) Furniture

Answer: C

Diff: 2 Page Ref: 35-36

Question Status: Existing/Old

6) Property such as a person's home, car, and furniture is called

- A) liquid assets.
- B) household assets.
- C) major property assets.
- D) investment assets.

Answer: B

Diff: 1 Page Ref: 35

Question Status: Existing/Old

7) Investment assets are all of the following **except**

- A) stocks.
- B) automobiles.
- C) bonds.
- D) rental property.

Answer: B

Diff: 1 Page Ref: 36

Question Status: Existing/Old

8) When a person owns corporate stocks, government or corporate bonds, or mutual funds, these are called

- A) liquid assets.
- B) household assets.
- C) investment assets.
- D) retirement assets.

Answer: C

Diff: 1 Page Ref: 36

Question Status: Existing/Old

9) Which of the following is **not** a true statement about mutual funds?

- A) They are managed by professional managers
- B) Proceeds are only invested in stocks
- C) Minimum investment is required
- D) The value of shares is reported in *The Wall Street Journal*

Answer: B

Diff: 2 Page Ref: 36

Question Status: Existing/Old

10) Balance sheet assets should be valued at

- A) original purchase price.
- B) replacement value.
- C) insured value.
- D) fair market value.

Answer: D

Diff: 2 Page Ref: 35

Question Status: Existing/Old

11) Bills that are to be paid off within a year are called

- A) short-term liabilities.
- B) one-year liabilities.
- C) current liabilities.
- D) insignificant bills.

Answer: C

Diff: 2 Page Ref: 36

Question Status: Existing/Old

12) Liabilities can be calculated by

- A) adding assets plus net worth.
- B) subtracting net worth from assets.
- C) adding assets plus income.
- D) subtracting expenses from assets.

Answer: B

Diff: 3 Page Ref: 36

Question Status: Existing/Old

13) Liabilities include all of the following **except**

- A) this year's monthly car payments on a three-year loan.
- B) the total mortgage on a home.
- C) the amount due on a credit card.
- D) the pay-off on a student loan.

Answer: A

Diff: 2 Page Ref: 36

Question Status: Existing/Old

14) Student loans, car loans, and housing loans are good examples of

- A) long-term liabilities.
- B) current liabilities.
- C) short-term debts.
- D) personal obligations.

Answer: A

Diff: 1 Page Ref: 36

Question Status: Existing/Old

15) The difference between assets and liabilities is called

- A) surplus.
- B) deficit.
- C) net income.
- D) net worth.

Answer: D

Diff: 1 Page Ref: 36

Question Status: Existing/Old

16) Another term for your wealth calculated by deducting money that you owe from the value of the things you own is

- A) gross income.
- B) net income.
- C) net property.
- D) net worth.

Answer: D

Diff: 1 Page Ref: 36

Question Status: Existing/Old

17) A personal balance sheet presents

- A) amounts budgeted for spending.
- B) income and expenses for a period of time.
- C) earnings on savings and investments.
- D) items owned and amounts owed.

Answer: D

Diff: 2 Page Ref: 34-35

Question Status: Existing/Old

18) A personal balance sheet summarizes

- A) income and expenses.
- B) cash inflows and outflows.
- C) assets, net worth, and income.
- D) assets, liabilities, and net worth.

Answer: D

Diff: 2 Page Ref: 35

Question Status: Existing/Old

19) In the balance sheet, a(n) _____ in assets _____ net worth.

- A) increase; increases
- B) decrease; increases
- C) Both A and D are correct.
- D) decrease; decreases

Answer: C

Diff: 2 Page Ref: 36

Question Status: Existing/Old

20) Jennifer has assets of \$100,000 and \$10,000 of debt. She could

- A) borrow more money, since her debt ratio is low.
- B) apply for a bank loan, but expect to be turned down.
- C) borrow approximately \$200,000 at below market rates.
- D) not borrow more money until she paid off her current debt.

Answer: A

Diff: 2 Page Ref: 40

Question Status: Existing/Old

21) The current financial position of an individual or family is best presented with the use of a

- A) budget.
- B) cash flow statement.
- C) balance sheet.
- D) bank statement.

Answer: C

Diff: 2 Page Ref: 35

Question Status: Existing/Old

22) Your current liquidity ratio is 2.0. If you take money out of your savings account to pay off a credit card your liquidity ratio will

- A) increase.
- B) decrease.
- C) stay the same.
- D) More data is needed to determine what affect this action will have.

Answer: A

Diff: 3 Page Ref: 40

Question Status: Existing/Old

23) If you sell stock from your portfolio to pay off your car loan, your debt ratio of 0.5 will

- A) increase.
- B) decrease.
- C) stay the same.
- D) More data is needed to determine what affect this action will have.

Answer: B

Diff: 3 Page Ref: 40

Question Status: Existing/Old

- 24) Nancy has \$40,000 of annual disposable income and saves \$8,000 a year. Her savings rate is
- A) 5%.
 - B) 12%.
 - C) 17%.
 - D) 20%.

Answer: D

Diff: 1 Page Ref: 40

Question Status: Existing/Old

- 25) If you save the same dollar amount from each paycheck during your career as your income increases, your savings rate will
- A) increase.
 - B) decrease.
 - C) stay the same.
 - D) More data is needed to determine what affect this action will have.

Answer: B

Diff: 2 Page Ref: 40

Question Status: Existing/Old

- 26) If Jo Ann had \$4,000 in liquid assets and \$1,000 in current liabilities, she would have a liquidity ratio of
- A) 0.25.
 - B) 4.0.
 - C) 1,000.
 - D) 4,000.

Answer: B

Diff: 3 Page Ref: 40

Question Status: Existing/Old

- 27) A low liquidity ratio means
- A) that you have very few debts.
 - B) that liquid assets are increasing faster than current debt.
 - C) that you probably will have trouble paying your current bills.
 - D) that you have many liquid assets.

Answer: C

Diff: 2 Page Ref: 40

Question Status: Existing/Old

- 28) Paying cash for an Alaskan cruise would
- A) increase assets.
 - B) decrease assets.
 - C) increase net worth.
 - D) decrease liabilities.

Answer: B

Diff: 1 Page Ref: 35

Question Status: Existing/Old

29) Paying off a credit card with cash will have the following effect on net worth.

- A) Increase
- B) Decrease
- C) No effect
- D) Insufficient data

Answer: C

Diff: 2 Page Ref: 36

Question Status: Existing/Old

30) Which of the following will **not** increase your liquidity ratio?

- A) Purchasing a stereo on credit
- B) Paying off a credit card
- C) Selling stock for a gain
- D) More data needed

Answer: D

Diff: 3 Page Ref: 40

Question Status: Existing/Old

31) If your current debt to asset ratio is 50%, which of the following will increase it?

- A) Taking out a home equity loan
- B) Buying a car with cash
- C) Paying off a student loan
- D) Buying stock with cash

Answer: C

Diff: 3 Page Ref: 40

Question Status: Existing/Old

Short Answer

1) The cash in your wallet, your checking account balance, and your savings account comprise your _____ assets.

Answer: liquid

Page Ref: 35

Question Status: Existing/Old

2) If your monthly disposable income equals \$1,500 and you currently save \$500/month, your savings rate is _____.

Answer: 33%

Page Ref: 40

Question Status: Existing/Old

Matching

Match the following:

- A) debt paid within a year
- B) certificates representing partial ownership of a firm
- C) shares of a portfolio comprised of stocks and bonds
- D) certificates issued by borrowers to raise funds
- E) financial assets that can be easily sold without a loss

1) liquid assets

Question Status: Existing/Old

2) bonds

Question Status: Existing/Old

3) stocks

Question Status: Existing/Old

4) mutual funds

Question Status: Revised

5) current liabilities

Question Status: Existing/Old

Answers: 1) E 2) D 3) B 4) C 5) A

Essay

1) List three components of your personal balance sheet and two components of your income statement.

Answer: The balance sheet includes assets, liabilities, and net worth. The income statement includes income and expenses.

Page Ref: 35-36

Question Status: Existing/Old

2) Determine if the following are liquid assets or household assets by placing an L or H beside the following.

_____ Car
_____ Home
_____ Checking account
_____ Furniture
_____ Cash
_____ Savings account

Answer:

H Car
H Home
L Checking account
H Furniture
L Cash
L Savings account

Page Ref: 35

Question Status: Existing/Old

3) Judy has cash inflows of \$3,000 for the month of June. Her expenses or cash outflows were \$4,000. What is her net cash flow? List two options for Judy to meet her financial obligations in June. What is the effect (increase or decrease) of these options on her assets and liabilities?

Answer: Net cash flow is a negative \$1,000. Her options include taking money out of her investments (asset reduction) or borrowing money (increase liabilities).

Page Ref: Various

Question Status: Existing/Old

4) Jerry has assets of \$200,000, a net worth of \$150,000, and an annual income of \$100,000. What are Jerry's liabilities?

- (a) \$100,000
- (b) \$250,000
- (c) \$50,000
- (d) \$450,000

Answer: (c) $\$200,000 - \$150,000 = \$50,000$

Page Ref: 36

Question Status: Existing/Old

5) If you have current assets of \$20,000 and current liabilities of \$10,000, then you

- (a) have a current liquidity ratio of 2.
- (b) are in poor shape with a liquidity ratio of 0.5.
- (c) may have trouble paying your bills depending on their due dates.
- (d) are overextended by \$10,000

Answer: (a) $\$20,000/\$10,000 = 2$

Page Ref: 40

Question Status: Existing/Old

6) A family with \$45,000 in assets and \$22,000 in liabilities would have a net worth of

(a) \$45,000.

(b) \$23,000.

(c) \$22,000.

(d) \$67,000.

Answer: (b) $\$45,000 - \$22,000 = \$23,000$

Page Ref: 36

Question Status: Existing/Old

7) David's liquidity ratio is 3.0. He has \$1,000 in current liabilities. Therefore, he has _____ worth of liquid assets.

(a) \$3,000

(b) \$333

(c) \$4,000

(d) \$700

Answer: (a)

$x/\$1,000 = 3.0$

$x = \$3,000$

Page Ref: 40

Question Status: Existing/Old

2.5 How Budgeting Fits Within Your Financial Plan

True or False

1) Your net worth can change even if your net cash flows are zero.

Answer: TRUE

Diff: 3 Page Ref: 41

Question Status: Existing/Old

Multiple Choice

1) Which of the following actions will **not** increase your net worth?

A) Country club dues paid monthly

B) Contributions to a mutual fund paid monthly

C) Car payments paid monthly

D) Home mortgage payments paid monthly

Answer: A

Diff: 3 Page Ref: 41

Question Status: Existing/Old

2) A person's net worth would increase as a result of

- A) reducing amounts owed to others.
- B) reducing earnings.
- C) decreasing the value of assets.
- D) increasing spending on current living expenses.

Answer: A

Diff: 2 Page Ref: 41

Question Status: Existing/Old

3) The net worth of an individual or family can be increased by

- A) increasing spending.
- B) increasing liabilities.
- C) decreasing assets.
- D) increasing income.

Answer: D

Diff: 1 Page Ref: 41

Question Status: Existing/Old

4) The best measure of a person's or family's wealth is

- A) the amount of salary earned annually.
- B) net worth.
- C) the total dollar value of investment assets.
- D) the market value of real estate including the personal home.

Answer: B

Diff: 1 Page Ref: 41

Question Status: Existing/Old

Short Answer

1) If your net cash inflows exceed your net cash outflows, you can increase your net worth by investing the difference in more _____.

Answer: assets

Page Ref: 41

Question Status: Existing/Old

Essay

1) If your cash outflows are \$600 and your cash inflows are \$1,000, you can increase your net worth by:

- (a) \$1,000.
- (b) \$600.
- (c) \$1,600.
- (d) \$400.

Answer: (d) $\$1,000 \pm \$600 = \$400$

Page Ref: 41

Question Status: Existing/Old