

Personal Finance, 5e (Madura)

Chapter 2 Planning with Personal Financial Statements

2.1 Personal Cash Flow Statement

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

Answer: FALSE

Diff: 2

Question Status: Previous edition

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

Answer: FALSE

Diff: 1

Question Status: Previous edition

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

Answer: FALSE

Diff: 3

Question Status: Previous edition

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

Answer: TRUE

Diff: 1

Question Status: Previous edition

5) The primary goal of financial planning is to

A) increasing earnings.

B) maximize cash inflows.

C) maximize wealth.

D) minimize financial risk.

Answer: C

Diff: 1

6) 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

Question Status: Previous edition

7) 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

Question Status: Previous edition

8) 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

Question Status: Previous edition

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

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

Answer: C

Diff: 1

Question Status: Previous edition

10) 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

Question Status: Previous edition

11) Cash outflows are also called

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

Answer: B

Diff: 1

Question Status: Previous edition

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

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

Answer: A

Diff: 1

Question Status: Previous edition

13) 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

Question Status: Previous edition

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

Answer: personal cash flow statement

Question Status: Previous edition

Use the following two columns of items to answer the matching questions:

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

15) cash flow statement

Question Status: Previous edition

16) household assets

Question Status: Previous edition

17) balance sheet

Question Status: Previous edition

18) net cash flows

Question Status: Previous edition

Answers: 15) B 16) D 17) C 18) A

2.2 Factors That Affect Cash Flows

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

Answer: FALSE

Diff: 1

Question Status: Previous edition

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

Answer: TRUE

Diff: 1

Question Status: Previous edition

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

Answer: FALSE

Diff: 1

Question Status: Previous edition

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

Question Status: Previous edition

5) 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

Question Status: Previous edition

6) 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

Question Status: Previous edition

7) 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

Question Status: Previous edition

8) 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

Question Status: Previous edition

9) 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

Question Status: Previous edition

10) 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

Question Status: Previous edition

2.3 Creating a Budget

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

Answer: TRUE

Diff: 2

Question Status: Previous edition

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

Question Status: Previous edition

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

Answer: FALSE

Diff: 3

Question Status: Previous edition

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

Answer: TRUE

Diff: 1

Question Status: Previous edition

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

Question Status: Previous edition

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

Question Status: Previous edition

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

Question Status: Previous edition

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

Answer: TRUE

Diff: 1

Question Status: Previous edition

9) 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

Question Status: Previous edition

10) A cash flow statement that is based on forecasted cash flows for a future time period is called a(n)

A) cash outflow.

B) net cash flow.

C) income statement.

D) budget.

Answer: D

Diff: 3

11) 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

Question Status: Previous edition

12) 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

Question Status: Previous edition

13) 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

Question Status: Previous edition

14) 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

Question Status: Previous edition

15) 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

Question Status: Previous edition

16) Allison expects her monthly cash inflow after taxes to be \$3000. She also has the following monthly expenses: Rent, \$750; student loan payment, \$200; utilities, \$150; food, \$300; recreation, \$600; car expenses, \$200; clothing, \$150. What is Allison's net cash flow for the current month?

- A) \$2,350
- B) \$650
- C) (\$650)
- D) \$3000

Answer: B

Diff: 2

17) Allison anticipates an additional car expense two months from now of \$400 for new tires that she has not previously budgeted for. What action should Allison take?

A) Nothing; wait another month to consider the expense since she doesn't need the tires for another two months.

B) Plan to use her credit card to purchase the tires. Then she won't have to use her excess cash.

C) Revise her car expenses over the next two months to allow for the additional cost of the new tires.

D) Ask her parents for the money for the new tires.

Answer: C

Diff: 2

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

Answer: budget

Question Status: Previous edition

19) 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.

Question Status: Previous edition

2.4 Personal Balance Sheet

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

Answer: FALSE

Diff: 2

Question Status: Previous edition

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

Answer: FALSE

Diff: 1

Question Status: Previous edition

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

Question Status: Previous edition

4) Which of the following is **not** an asset you might find on a personal balance sheet?

- A) Liquid assets
- B) Inventory
- C) Household assets
- D) Personal investments

Answer: B

Diff: 2

5) 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

Question Status: Previous edition

6) 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

Question Status: Revised

7) 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

Question Status: Previous edition

8) 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

Question Status: Previous edition

9) 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

Question Status: Previous edition

10) 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

Question Status: Previous edition

11) The value of an asset you would receive if you sold the asset today is called

- A) market value.
- B) book value.
- C) sales value.
- D) cost.

Answer: A

Diff: 1

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

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

Answer: B

Diff: 1

Question Status: Previous edition

13) 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

Question Status: Previous edition

14) An investment in which shares are sold to individuals and then proceeds are invested in stocks or bonds is called a

- A) current liability.
- B) mutual fund.
- C) stocks.
- D) bonds.

Answer: B

Diff: 1

15) 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

Question Status: Previous edition

16) Corporations issue stocks for all of the following reasons **except**

- A) to purchase new machinery.
- B) to borrow money from shareholders.
- C) to fund a plant expansion.
- D) to loan money to shareholders.

Answer: D

Diff: 2

17) Which of the following statements about stocks is **not** true?

- A) Stocks represent partial ownership of a firm.
- B) Corporations issue stocks to obtain money for special projects.
- C) Investments in stocks are considered liquid assets.
- D) The market value of stocks changes daily.

Answer: C

Diff: 2

18) 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

Question Status: Previous edition

19) 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

Question Status: Previous edition

20) 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

Question Status: Previous edition

21) 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

Question Status: Previous edition

22) 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

Question Status: Previous edition

23) The difference between assets and liabilities is called

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

Answer: D

Diff: 1

Question Status: Previous edition

24) 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

Question Status: Previous edition

25) 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

Question Status: Previous edition

26) 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

Question Status: Previous edition

27) 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

Question Status: Previous edition

28) 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

Question Status: Previous edition

- 29) 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

Question Status: Previous edition

- 30) 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

Question Status: Previous edition

- 31) 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

Question Status: Previous edition

- 32) Margaret has \$5,000 in her checking account, a home with a market value of \$175,000, and stocks valued at \$10,000. Margaret also has a credit card debt of \$15,000. Margaret's liquidity ratio is
- A) 1.00.
 - B) 12.00.
 - C) 12.67.
 - D) .33.

Answer: D

Diff: 3

- 33) 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

Question Status: Previous edition

34) 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

Question Status: Previous edition

35) Bill's annual savings rate is 9%. If Bill wants to increase his savings rate by 2% and he currently saves \$6,750, how much additional savings will Bill need to contribute to achieve his savings goal of 11%?

- A) \$8,250
- B) \$135
- C) \$1,500
- D) more data needed to determine the answer

Answer: C

Diff: 2

36) 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

Question Status: Previous edition

37) 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

Question Status: Previous edition

38) Paying cash for an Alaskan cruise would

- A) increase assets.
- B) decrease assets.
- C) increase net worth.
- D) decrease liabilities.

Answer: B

Diff: 1

Question Status: Previous edition

39) Paying off a credit card with cash will have which of the following effects on net worth?

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

Answer: C

Diff: 2

Question Status: Previous edition

40) 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

Question Status: Previous edition

41) 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

Question Status: Previous edition

42) If Kim's current debt ratio is 45%, this means that _____ of Kim's assets are purchased on credit.

- A) 55%
- B) 45%
- C) 50%
- D) not enough data to determine the answer

Answer: B

Diff: 3

43) 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

Question Status: Previous edition

- 44) 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 over-extended by \$10,000.

Answer: A

Question Status: Previous edition

- 45) 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

Question Status: Previous edition

- 46) 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

Question Status: Previous edition

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

Answer: liquid

Question Status: Previous edition

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

Answer: 33%

Question Status: Previous edition

Use the following two columns of items to answer the matching questions:

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

49) liquid assets

Question Status: Previous edition

50) bonds

Question Status: Previous edition

51) real estate

Question Status: Previous edition

52) stocks

Question Status: Previous edition

53) mutual funds

Question Status: Revised

54) current liabilities

Question Status: Previous edition

Answers: 49) D 50) A 51) E 52) F 53) C 54) B

55) 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.

Question Status: Previous edition

56) 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

Question Status: Previous edition

57) 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).

Question Status: Previous edition

2.5 How Budgeting Fits Within Your Financial Plan

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

Answer: TRUE

Diff: 3

Question Status: Previous edition

2) 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

Question Status: Previous edition

3) 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

Question Status: Previous edition

4) 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

Question Status: Previous edition

5) 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

Question Status: Previous edition

6) 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

Question Status: Previous edition

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

Answer: assets

Question Status: Previous edition