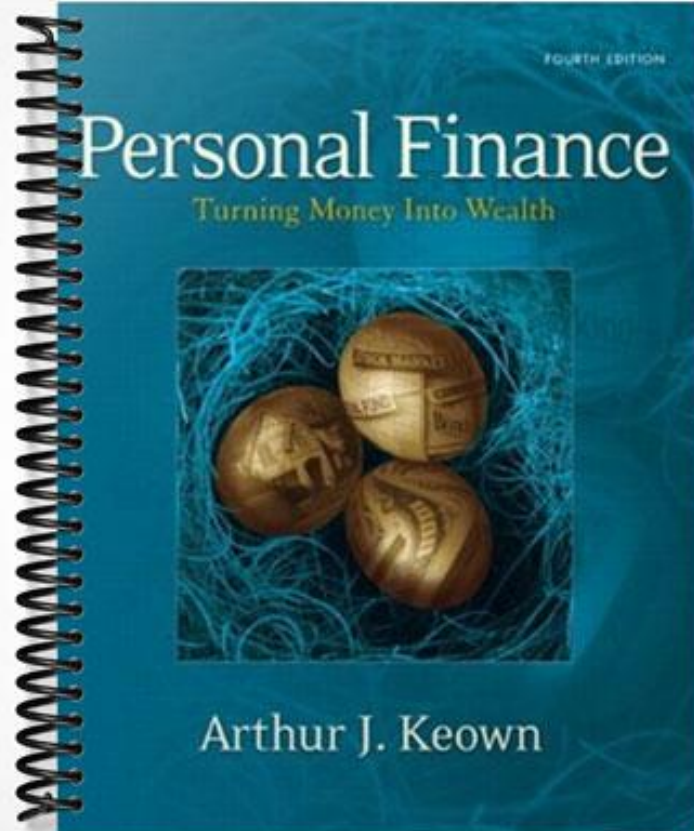


TEST BANK



Personal Finance, 4e (Keown)

Chapter 2 Measuring Your Financial Health and Making a Plan

2.1 Matching

Match the following.

1) Principle #8 - the planning principle

Diff: 1

Topic: Nothing Happens Without a Plan

2) Net worth or equity

Diff: 1

Topic: Net Worth

3) Fixed expenditure

Diff: 1

Topic: Expenditures

4) Budget

Diff: 1

Topic: Budget

5) Debt ratio

Diff: 1

Topic: Ratios

6) Personal balance sheet

Diff: 1

Topic: Balance Sheet

7) Blue book

Diff: 1

Topic: Balance Sheet

8) Assets

Diff: 1

Topic: Assets

A) What you owe or the borrowing of money

B) A listing of used car prices and trade-in values

C) Plan for controlling cash inflows and cash outflows based upon plans and obligations

D) What an asset can be sold for at the present time

E) Expenditure - you have no control - obligated to make a constant level each month

F) Statement of financial position on a given date including assets, liabilities, and net worth

G) Total debt or liabilities divided by total assets

H) What you own

I) Something physical that has value

J) Expenditure over which you have control and no obligation to make because it varies

K) Book or notebook set aside to record your expenditures in

9) Insolvent

Diff: 1

Topic: Balance Sheet

10) Income statement

Diff: 1

Topic: Income Statement

11) Liabilities

Diff: 1

Topic: Liabilities

12) Fair market value

Diff: 1

Topic: Fair Market Value

13) Variable expenditure

Diff: 1

Topic: Expenditures

14) Tangible asset

Diff: 1

Topic: Assets

15) Principle #13 - pay yourself first

Diff: 1

Topic: Pay Yourself First

16) Ledger

Diff: 1

Topic: Income Statement

17) Current ratio

Diff: 1

Topic: Ratios

L) Monetary assets divided by current liabilities

M) Measures the level of wealth by subtracting debt from assets

N) Making your financial well-being your top priority

O) The statement that tells where your money comes from and goes over some period of time

P) Nothing happens without a plan - even (or especially) a simple one

Q) The condition in which you owe more money than your assets are worth

- | | | | | | |
|-------|-------|-------|-------|-------|-------|
| 1) P | 2) M | 3) E | 4) C | 5) G | 6) F |
| 7) B | 8) H | 9) Q | 10) O | 11) A | 12) D |
| 13) J | 14) I | 15) N | 16) K | 17) L | |

2.2 True or False

- 1) To achieve your financial goals you will need to measure your financial health and develop a plan and a budget.
Answer: TRUE
Diff: 1
Topic: *Nothing Happens Without a Plan*
- 2) A personal balance sheet is a statement of your financial position over a certain time period.
Answer: FALSE
Diff: 1
Topic: *Balance Sheet*
- 3) To determine your level of net worth subtract your assets from what you owe.
Answer: FALSE
Diff: 1
Topic: *Net Worth*
- 4) Current liabilities are those that must be paid off within the next year.
Answer: TRUE
Diff: 1
Topic: *Liabilities*
- 5) A house that you have leased to live in is an example of a tangible asset.
Answer: FALSE
Diff: 1
Topic: *Assets*
- 6) An income statement tracks the amount of money you have coming in and going out over some period of time.
Answer: TRUE
Diff: 1
Topic: *Income Statement*
- 7) Personal income statements are based on actual cash flows.
Answer: TRUE
Diff: 1
Topic: *Income Statement*
- 8) Using financial ratios helps you analyze the raw figures provided in your personal income statement and balance sheet.
Answer: TRUE
Diff: 1
Topic: *Ratios*
- 9) The current ratio measures your ability to cover your current liabilities.
Answer: TRUE
Diff: 1
Topic: *Ratios*

- 10) Investors require a higher expected rate of return on assets with higher liquidity.
Answer: FALSE
Diff: 1
Topic: Risk-Return Tradeoff
- 11) The best way to save money is to spend the amount of money you desire and then what remains is your savings.
Answer: FALSE
Diff: 1
Topic: Pay Yourself First
- 12) If you have hired a professional financial manager to manage your finances you are no longer responsible for implementing your financial plan.
Answer: FALSE
Diff: 1
Topic: Knowledge is the Best Protection
- 13) As long as a financial planner is certified you need not worry about his ability to provide you with the correct financial plan for your situation.
Answer: FALSE
Diff: 1
Topic: Professional Financial Planners

2.3 Multiple-Choice

- 1) The first step to take in measuring your financial condition is to create
- A) your debt ratio.
 - B) a personal balance sheet.
 - C) an income statement.
 - D) a list of liabilities.
 - E) a checking account.
- Answer: B
Diff: 2
Topic: Balance Sheet
- 2) Assets are best described as
- A) monetary assets that you own.
 - B) financial debts and obligations for which you owe.
 - C) your net worth.
 - D) adjusted gross income.
 - E) tangible items of value that you own.
- Answer: A
Diff: 2
Topic: Balance Sheet

- 3) Liabilities are best described as
- A) monetary items of value that you own.
 - B) financial debts and obligations for which you owe.
 - C) your net worth.
 - D) adjusted gross income.
 - E) intangible debts and obligations.

Answer: B

Diff: 2

Topic: Liabilities

- 4) Net worth, or your general level of worth, is found by
- A) subtracting expenses from income.
 - B) dividing monetary assets by current liabilities.
 - C) subtracting liabilities from assets.
 - D) dividing monthly debt (less mortgage payment) by monthly income.
 - E) subtracting current liabilities from monetary assets.

Answer: C

Diff: 1

Topic: Net Worth

- 5) Fair market value refers to
- A) the cost of your assets.
 - B) the value of assets when you plan to sell them.
 - C) the current value of assets.
 - D) the cost of assets less depreciation.
 - E) the current value of assets less depreciation.

Answer: C

Diff: 2

Topic: Fair Market Value

- 6) An intangible asset, as opposed to a tangible asset, is one that
- A) is physical and can be observed with the senses.
 - B) is not physical and cannot be observed with the senses.
 - C) cannot be accounted for on a balance sheet.
 - D) is difficult to place a fair market value on.
 - E) cannot be put on paper.

Answer: B

Diff: 3

Topic: Assets

- 7) Which of the following is not one of the major types of assets?
- A) monetary
 - B) investments
 - C) mortgage
 - D) retirement plans
 - E) personal property

Answer: C

Diff: 1

Topic: Assets

8) One of these is not a major type of liability. Which is it?

- A) home mortgage
- B) car loan
- C) credit card
- D) intangible debt
- E) unpaid bills

Answer: D

Diff: 2

Topic: Liabilities

9) You know you are insolvent when

- A) your expenses exceed your income.
- B) your assets are less than your liabilities.
- C) your net worth is negative.
- D) your debt ratio is too high.
- E) both B and C above

Answer: E

Diff: 3

Topic: Balance Sheet

10) A balance sheet can help in which of these practical ways?

- A) measure progress toward financial goals
- B) monitor financial well-being
- C) detect changes in financial standing
- D) understand how financially healthy you are
- E) all of the above

Answer: E

Diff: 2

Topic: Balance Sheet

11) _____ is a "good" level or amount of net worth.

- A) More than \$100,000
- B) More than \$250,000
- C) More than \$500,000
- D) depends on your goals and place in the financial life cycle
- E) none of the above

Answer: D

Diff: 3

Topic: Net Worth

12) Comparing this year's balance sheet to last year's balance sheet

- A) shows the progress you are making in your financial standing.
- B) shows the areas in which you overspent this year.
- C) helps to create your heirs' inheritances in your estate plans.
- D) itemizes your annual expenses.
- E) none of the above

Answer: A

Diff: 3

Topic: Balance Sheet

- 13) The easiest way to fail with a financial plan is to
- A) fail to revise and update it.
 - B) do it yourself.
 - C) use the wrong CPA.
 - D) lack self control and buy impulsively.
 - E) withdraw early from your retirement plan.

Answer: D

Diff: 3

Topic: Financial Plan

- 14) A listing of income and expenditures covering the same time period is a
- A) balance sheet.
 - B) income statement.
 - C) statement of net worth.
 - D) statement of financial ratios.
 - E) net income statement.

Answer: B

Diff: 1

Topic: Income Statement

- 15) A personal income statement is prepared
- A) on an accrual basis.
 - B) on a cash basis.
 - C) based on actual cash flows.
 - D) both B and C above
 - E) all of the above

Answer: C

Diff: 2

Topic: Income Statement

- 16) Practical uses of an income statement include
- A) determining whether you are earning more than you spend.
 - B) spotting problem areas of overspending.
 - C) determining if money is available for saving or investment.
 - D) knowing where your money is going.
 - E) all of the above

Answer: E

Diff: 2

Topic: Income Statement

- 17) An expenditure over which you have no control and are obligated to make is a
- A) variable expenditure.
 - B) fixed expenditure.
 - C) constant expenditure.
 - D) long-term expenditure.
 - E) decreasing expenditure.

Answer: B

Diff: 1

Topic: Expenditures

- 18) An expenditure over which you have control and which you are not obligated to make is
- A) variable.
 - B) fixed.
 - C) constant.
 - D) long-term.
 - E) increasing.

Answer: A

Diff: 1

Topic: Expenditures

- 19) The financial documents presented in this chapter can best be compared to a
- A) calendar.
 - B) things-to-do list.
 - C) planner.
 - D) roadmap.
 - E) none of the above

Answer: D

Diff: 3

Topic: Financial Plan

- 20) Which of the following might be found on an income statement?
- A) wages and salaries
 - B) interest and dividends
 - C) royalties, commissions, rents
 - D) other income
 - E) all of the above

Answer: E

Diff: 2

Topic: Income Statement

- 21) Which of the following are not typically found on a balance sheet?
- A) monetary assets
 - B) mortgage payments
 - C) market value of home
 - D) automobiles
 - E) personal property

Answer: B

Diff: 2

Topic: Balance Sheet

- 22) You have learned that a budget
- A) is never accurate, so don't try.
 - B) is a process of setting spending goals for the upcoming month or year.
 - C) is a plan for controlling cash inflows and cash outflows.
 - D) includes both actual and estimated expenses.
 - E) B and C above

Answer: E

Diff: 2

Topic: Budget

- 23) The purpose of using financial ratios is to
- A) impress your tax preparer.
 - B) memorize your financial figures.
 - C) analyze your raw data to compare to a standard.
 - D) better understand how you are managing your financial resources.
 - E) both C and D above

Answer: E

Diff: 3

Topic: Ratios

- 24) Which questions do financial ratios help you answer?
- A) Do I have adequate liquidity to meet emergencies?
 - B) Do I have the ability to meet my debt obligations?
 - C) Am I saving as much as I think I am?
 - D) all of the above
 - E) both A and B above

Answer: D

Diff: 2

Topic: Ratios

- 25) _____ is found by dividing monetary assets by current liabilities.
- A) Debt ratio
 - B) Current ratio
 - C) Net worth
 - D) Positive balance
 - E) Debt affordability

Answer: B

Diff: 1

Topic: Ratios

- 26) _____ is found by dividing total debt or liabilities by total assets.
- A) Debt ratio
 - B) Current ratio
 - C) Net worth
 - D) Positive balance
 - E) Debt affordability

Answer: A

Diff: 1

Topic: Ratios

- 27) Making your financial well-being the top priority is
- A) an ideal.
 - B) not necessary.
 - C) the pay yourself first principle #13.
 - D) too materialistic.
 - E) none of the above

Answer: C

Diff: 1

Topic: Make Your Financial Well-Being Your Top Priority

28) Which type of recordkeeping system is best to use with personal finances?

- A) pencil and a notebook
- B) computerized
- C) let your accountant figure it out
- D) the one that you will use
- E) any one will do

Answer: D

Diff: 2

Topic: Record Keeping

29) The type of expenditure whose tracking causes the most concern is

- A) credit card.
- B) cash.
- C) check.
- D) borrowing.
- E) risky investments.

Answer: B

Diff: 1

Topic: Expenditures

30) Which of the following options is best when deciding who should manage your finances?

- A) Do them yourself.
- B) Make your own plan and have it checked.
- C) Cooperatively develop a plan with a professional financial planner.
- D) Let the pro develop your entire plan.
- E) Any one of the above can work depending on your level of understanding and expertise.

Answer: E

Diff: 2

Topic: Financial Plan

31) Which of the following financial documents would you use to create a financial plan?

- A) balance sheet
- B) income statement
- C) budget
- D) cash budget
- E) all of the above

Answer: E

Diff: 3

Topic: Financial Plan

32) One of the following items would not go on a balance sheet. Which one is it?

- A) current bills
- B) credit card debt
- C) house payment
- D) automobile loan
- E) other debt

Answer: C

Diff: 3

Topic: Balance Sheet

- 33) Of what use is a balance sheet in creating a financial plan?
- A) It helps you measure progress toward financial goals.
 - B) It monitors financial well-being.
 - C) It can detect changes in financial standing.
 - D) It can help you understand how financially healthy you are.
 - E) all of the above

Answer: E

Diff: 2

Topic: Balance Sheet

- 34) How would an income statement benefit one in creating a financial plan?
- A) Determine whether one is earning more than one spends.
 - B) Spot problem areas of overspending.
 - C) Determine if money is available for saving or investment.
 - D) Know where one's money is going.
 - E) all of the above

Answer: E

Diff: 2

Topic: Income Statement

- 35) Which of the following questions would financial ratios help you answer?
- A) Do I have adequate liquidity to meet emergencies?
 - B) Do I have the ability to meet my debt obligations?
 - C) Am I saving as much as I think I am?
 - D) both A and B above
 - E) A, B, and C above

Answer: E

Diff: 1

Topic: Ratios

- 36) Which type of expenditure would probably be the hardest for an individual to track?
- A) credit card
 - B) cash
 - C) checks written
 - D) children's bills
 - E) direct deposits

Answer: B

Diff: 2

Topic: Expenditures

- 37) Which of the following will be the best type of record keeping system to use in maintaining financial records?
- A) manual method with pencil and notebook
 - B) computer software
 - C) the CPA's system
 - D) one you will actually use
 - E) Any record system out there will do.

Answer: D

Diff: 1

Topic: Record Keeping

- 38) Under what conditions should people hire a professional financial planner?
- A) when they need someone to validate the plan they prepared themselves
 - B) when they have run out of suggestions for improving it
 - C) when it is apparent their financial planning skills are limited
 - D) when they run into complex tax or legal issues
 - E) all of the above

Answer: E

Diff: 3

Topic: Professional Financial Planners

- 39) Which of the following are not relevant questions to ask a financial planner?
- A) What are your credentials and professional designations?
 - B) Where did you go to college?
 - C) Would you provide us with references?
 - D) Would you show us a similar financial plan you have done for someone else?
 - E) Will you provide us with a written estimate of your services and their cost?

Answer: B

Diff: 3

Topic: Professional Financial Planners

- 40) Suppose that you are currently financially "unhealthy." How would you know when you become financially healthy again?
- A) by understanding your financial documents
 - B) by using financial ratios
 - C) by using a financial plan
 - D) by using a record keeping system that works for you
 - E) all of the above

Answer: E

Diff: 3

Topic: Financial Health

- 41) Suppose that you have been operating a marketing business out of your home. It has recently expanded beyond belief. Since you have neglected your finances for some time, what would you do as a first step?
- A) Forget about the past, and begin your financial plan and record keeping as of today.
 - B) Separate your family finances from the business finances.
 - C) Wait until the end of the year to get organized since it's already October.
 - D) Disband the idea of expanding the business because the records are a mess.
 - E) Dump all of the financial transactions on an accountant's desk.

Answer: B

Diff: 3

Topic: Financial Plan

- 42) Which financial planning document should you use to measure your current level of wealth?
- A) budget
 - B) cash budget
 - C) balance sheet
 - D) income statement
 - E) statement of financial ratios

Answer: C

Diff: 2

Topic: Balance Sheet

- 43) What would be the primary consideration for the owner of a young business that is expanding rapidly?
- A) cash flow
 - B) Get out of debt.
 - C) Find the cheapest accountant.
 - D) Quit the full-time job.
 - E) Ask the spouse to quit his or her part-time job.

Answer: A

Diff: 3

Topic: Cash Flows

- 44) Which of the following would you check if you were concerned about money emergencies?
- A) months of living expenses covered ratio
 - B) debt ratio
 - C) long-term debt coverage ratio
 - D) current ratio
 - E) none of the above

Answer: D

Diff: 2

Topic: Ratios

- 45) How would you advise a young couple that has had a successful "home" business that needs capital for expansion to manage their finances?
- A) Go it alone.
 - B) Have a professional check their plan.
 - C) Cooperatively work out a plan with a professional.
 - D) Leave it all in the hands of a pro.
 - E) none of the above

Answer: C

Diff: 3

Topic: Professional Financial Planners

- 46) Items of value that you own are called
- A) assets.
 - B) liabilities.
 - C) debts.
 - D) expenses.
 - E) none of the above

Answer: A

Diff: 1

Topic: Assets

47) Items on the balance sheet that represent amounts owed others are termed

- A) assets.
- B) liabilities.
- C) revenues.
- D) expenses.
- E) none of the above

Answer: B

Diff: 2

Topic: Liabilities

48) What is found by subtracting the level of your debt or borrowings from the value of your assets?

- A) net worth
- B) liabilities
- C) current assets
- D) current liabilities
- E) none of the above

Answer: A

Diff: 2

Topic: Net Worth

49) What is the value that represents what an asset could be sold for, rather than what it cost or what it will be worth sometime in the future?

- A) depreciated value
- B) taxable value
- C) book value
- D) fair market value
- E) none of the above

Answer: D

Diff: 2

Topic: Fair Market Value

50) Suppose that you are trying to purchase a used car. You would most likely find a listing of used car prices in the

- A) Red Book.
- B) Blue Book.
- C) Yellow Book.
- D) Green Book.
- E) none of the above

Answer: B

Diff: 1

Topic: Blue Book

- 51) A physical asset, such as a house or car, is called a(n) _____.
- A) tangible asset
 - B) financial asset
 - C) investment
 - D) liability
 - E) none of the above

Answer: A

Diff: 2

Topic: Assets

- 52) The condition in which you owe more money than your assets are worth is called
- A) bankruptcy.
 - B) unbalanced.
 - C) instability.
 - D) insolvency.
 - E) none of the above

Answer: D

Diff: 3

Topic: Net Worth

- 53) A statement that records where your money has come from and where it has gone over some period of time is called a(n)
- A) income statement.
 - B) balance sheet.
 - C) statement of net worth.
 - D) statement of changes in financial position.
 - E) none of the above

Answer: A

Diff: 2

Topic: Income Statement

- 54) An expenditure over which you have control, are not obligated to make, and may vary from month to month is call a _____ expenditure.
- A) fixed
 - B) variable
 - C) liquid
 - D) vacillating
 - E) none of the above

Answer: B

Diff: 1

Topic: Expenditures

55) An expenditure over which you have no control, are obligated to make, and is generally at a constant level each month is called a _____ expenditure.

- A) fixed
- B) variable
- C) stationary
- D) discretionary
- E) none of the above

Answer: A

Diff: 1

Topic: Expenditures

56) A plan for controlling cash inflows and cash outflows is called a(n) _____.

- A) income statement
- B) balance sheet
- C) cash budget
- D) statement of changes in financial position
- E) none of the above

Answer: C

Diff: 1

Topic: Budget

57) Suppose that you wanted to calculate a financial ratio measuring your liquidity. You would likely use the _____ ratio.

- A) debt
- B) long-term debt coverage
- C) savings
- D) current
- E) none of the above

Answer: D

Diff: 2

Topic: Ratios

58) A(n) _____ is a book or notebook set aside to record expenditures.

- A) blue book
- B) ledger
- C) cash budget
- D) income statement
- E) none of the above

Answer: B

Diff: 2

Topic: Ledger

- 59) Suppose that you were trying to determine how much income was available for future monetary needs as well as for investment. You would most likely use which of the following ratios?
- A) current ratio
 - B) debt ratio
 - C) savings ratio
 - D) total asset turnover
 - E) none of the above

Answer: C

Diff: 1

Topic: Ratios

- 60) Suppose that Cheryl's only assets are an automobile worth \$10,000 and a checking account with a \$5,000 balance. Her only liabilities are a student loan balance of \$2,000 and a balance of \$8,000 on her car loan. What is her net worth?
- A) \$10,000
 - B) \$8,000
 - C) \$5,000
 - D) \$2,000
 - E) none of the above

Answer: C

Diff: 2

Topic: Net Worth

- 61) Suppose that Doug's only assets are an automobile worth \$10,000 and a checking account with a \$5,000 balance. His only liabilities are a student loan balance of \$12,000 and a balance of \$9,000 on his car loan. What is his net worth?
- A) \$21,000
 - B) \$15,000
 - C) \$6,000
 - D) Doug is currently insolvent.
 - E) None of the above statements are correct.

Answer: D

Diff: 2

Topic: Net Worth

Maria Montez

Maria Montez has just graduated from college and is ready to begin her first job. Maria has always been a believer in planning for the future. She updated her resume one year before graduating and began a job search six months before finishing college. Her starting salary is \$25,000 and the job comes with great benefits. Maria wants to have a nice car and begin to immediately build a retirement plan with the savings from a conservative lifestyle. Maria must now decide how to begin her financial plan.

62) Which financial documents would you advise Maria to use?

- A) balance sheet
- B) income statement
- C) budget
- D) cash budget
- E) all of the above

Answer: E

Diff: 3

Topic: Financial Plan

63) One of the following items would not go on her balance sheet. Which one is it?

- A) current bills
- B) credit card debt
- C) house payment
- D) automobile loan
- E) other debt

Answer: C

Diff: 3

Topic: Balance Sheet

64) How would an income statement benefit Maria?

- A) determine whether she is earning more than she spends
- B) spot problem areas of overspending
- C) determine if money is available for saving or investment
- D) know where her money is going
- E) all of the above

Answer: E

Diff: 2

Topic: Income Statement

65) Financial ratios would help Maria answer which of the following questions?

- A) Do I have adequate liquidity to meet emergencies?
- B) Do I have the ability to meet my debt obligations?
- C) Am I saving as much as I think I am?
- D) A and B only
- E) A, B, and C above

Answer: E

Diff: 1

Topic: Ratios

George and Betty

George and Betty, a middle-age couple, have watched their savings account dwindle over the years. The high cost of living and helping their children financially are placing a strain on their ability to meet their short-term and long-term goals. They have both developed health problems and are concerned about being able to work until retirement at age 65. In the past they felt they understood their finances well enough because they have always prepared their own income tax returns. Now, at this point in their lives, financial planning has become paramount. They are seeking professional advice but still want to do some of their own planning to save money.

66) Which type of expenditure will probably be the hardest for George and Betty to track?

- A) credit card
- B) cash
- C) checks written
- D) children's bills
- E) direct deposits

Answer: B

Diff: 2

Topic: Expenditures

67) Which of the following will be the best type of record keeping system for them to use?

- A) manual method with pencil and notebook
- B) computer software
- C) the CPA's system
- D) one they will actually use
- E) Any record system out there will do.

Answer: D

Diff: 1

Topic: Record Keeping

68) At what point should George and Betty hire a professional financial planner?

- A) when they need someone to validate the plan they prepared themselves
- B) when they have run out of suggestions for improving it
- C) when it is apparent their financial planning skills are limited
- D) when they run into complex tax or legal issues
- E) all of the above

Answer: E

Diff: 3

Topic: Professional Financial Planners

69) Which of the following is not a relevant question for them to ask a financial planner?

- A) What are your credentials and professional designations?
- B) Where did you go to college?
- C) Would you provide us with references?
- D) Would you show us a similar financial plan you have done for someone else?
- E) Will you provide us with a written estimate of your services and their cost?

Answer: B

Diff: 3

Topic: Professional Financial Planners

- 70) How will George and Betty know when they have become financially healthy again?
- A) by understanding their financial documents
 - B) by using financial ratios
 - C) by using a financial plan
 - D) by using a record keeping system that works for them
 - E) all of the above

Answer: E

Diff: 3

Topic: Financial Health

Freddy Wong

Freddy works full-time as an assistant manager at a retail clothing store and his wife (Cathy) works part-time for an accountant. At night and on weekends they operate a marketing business out of their home. They began this business two years ago to start saving for their daughter's college education and to get out of debt. Something has happened. Their web page ad and reputation for service have boosted sales beyond their wildest dreams. They can't keep up with the orders and now must make a decision about expansion. Before the Wongs take this step, they must get their finances in order. They have been neglected because of the lack of time. It's Saturday night and they are pondering their dilemma.

- 71) What would you recommend the Wong couple do as a first step?
- A) Forget about the past and begin their financial plan and record keeping as of today.
 - B) Separate their family finances from the business finances.
 - C) Wait until the end of the year to get organized since it's already October.
 - D) Disband the idea of expanding the business because the records are in a mess.
 - E) Dump all of the financial transactions on an accountant's desk.

Answer: B

Diff: 3

Topic: Financial Plan

- 72) Which financial planning document should they use to measure their current level of wealth?
- A) budget
 - B) cash budget
 - C) balance sheet
 - D) income statement
 - E) statement of financial ratios

Answer: C

Diff: 2

Topic: Balance Sheet

- 73) The primary consideration for Freddy at this time is
- A) cash flow
 - B) getting out of debt
 - C) finding the cheapest accountant
 - D) quitting his full-time job
 - E) asking his wife to quit her part-time job

Answer: A

Diff: 3

Topic: Cash Flows

- 74) Cathy Wong is concerned about money emergencies. She should check their
- A) months of living expenses covered ratio.
 - B) debt ratio.
 - C) long-term debt coverage ratio.
 - D) current ratio.
 - E) none of the above

Answer: D

Diff: 2

Topic: Ratios

- 75) How would you advise the Wongs to manage their finances under the circumstances?
- A) Go it alone.
 - B) Have a professional check their plan.
 - C) Cooperatively work out a plan with a professional.
 - D) Leave it all in the hands of a pro.
 - E) none of the above

Answer: C

Diff: 3

Topic: Professional Financial Planners

2.4 Essay

- 1) Explain what goes on a balance sheet and its uses.

Answer: A personal balance sheet consists of three parts: assets, liabilities, and net worth.

Assets include the value of monetary assets, investments, retirement plans, housing, automobiles, personal property, and "other" assets. Liabilities consist of current bills, credit card debt, housing, automobile loans, and "other" debt. Your net worth consists of the part of your assets that are clear and free of debt. It is found by subtracting liabilities from assets. The balance sheet is a useful tool to see your current financial position. It is a good barometer to gauge your financial net worth over time by comparing quarters or years. It also supplies the numbers needed for developing financial ratios to determine your financial health against common standards.

Diff: 1

Topic: Balance Sheet

- 2) Describe an income statement and its functions.

Answer: An income statement consists of three parts: income, expenses, and surplus funds.

Income includes income from all sources from all parties contributing to the household. Typical expense items consist of housing, food, clothing and personal care, contributions, recreation, medical expenses, insurance, and transportation. Surplus funds tell if you have any money left over at the end of the month or if you spent more than you earned. An income statement shows an itemized list of expenditures and allows you to isolate areas where you are over spending. It is a good planning tool for budgets and income tax preparation.

Diff: 1

Topic: Income Statement

3) What questions do financial ratios help answer?

Answer: By calculating your current ratio you can answer the question, "Do I have adequate liquidity to meet emergencies?" Debt ratios answer, "Do I have the ability to meet my debt obligations?" "Am I saving as much as I think I am?" is answered by the savings ratio.

Diff: 2

Topic: Ratios

4) How do you calculate the current ratio, debt ratio, and savings ratio?

Answer: Current ratio is calculated by dividing the total of current assets by the total of current liabilities. A ratio of 1.0 will get you by, but a ratio of 2.0 or more is preferred. The debt ratio is determined by dividing total debt or liabilities by total assets. The savings ratio is found by dividing the income available for savings and investment by income available for living expenses.

Diff: 1

Topic: Ratios

5) Explain the steps in developing a cash budget.

Answer: First, determine your anticipated income by referring to last year's adjusted income. Next, estimate your level of taxes to determine after-tax income available for living expenses. Add fixed and variable expense estimates together to determine your level of spending. Last, subtract living expenditures from expected take-home pay to calculate income available for savings and investment.

Diff: 2

Topic: Budget

6) What are the four choices in managing your financial affairs?

Answer: The most simple approach is to manage your finances yourself. A second choice is to jointly plan your finances with a professional planner. A third choice is to let a professional planner put your entire plan together for you. If you still want to develop your own plan you might want a professional planner to validate what you have done rather than do the planning.

Diff: 2

Topic: Financial Plan

7) Tell how to implement the "envelope" budgeting system.

Answer: For those new to budgeting or those with small amounts of self-discipline, the envelope system is useful. Use a separate envelope for each major monthly expense, including one for miscellaneous, and label each with the expense name. Allocate the proper amount of money for each envelope expenditure from the appropriate paycheck/source of income. Use the money in each envelope only for its intended use and you should have enough to go around. As soon as possible, incorporate an envelope for savings and emergencies.

Diff: 3

Topic: Financial Plan

8) List the benefits a professional financial planner can offer.

Answer: A financial planner has the knowledge and skills to teach you the financial axioms.

The pro will be able to help you prepare balance sheets, income statements, budgets, financial ratios, as well as savings, investments, and retirement plans that are realistic from an objective point of view. A financial planner can save you much time and costly mistakes. He or she may suggest a computer software program to meet your individual needs as well as give tax advice. You want to develop a win-win situation with this person.

Diff: 2

Topic: Professional Financial Planners

9) Prepare a list of questions to ask a prospective financial planner you are considering.

Answer: 1. How long have you been a financial planner?

2. What are your credentials and professional designations?

3. Do you actively participate in continuing education to keep up with the times?

4. How do you keep up with the latest financial changes?

5. Will you provide us with references?

6. Will you let me see a copy of a financial plan you did for someone else in similar circumstances, of course with the name removed to preserve confidentiality?

7. Who will work with you and will the work be done by a junior staffer or a computer program?

8. How many companies do you represent?

9. How do you get paid □ fee, commission, or a combination? What will it be, how often are you paid, and how will your fee be calculated?

10. Will you provide a written estimate of the services I expect and the cost of those services?

Diff: 2

Topic: Professional Financial Planners