

TEST BANK

PERSONAL
FINANCE

THIRD EDITION



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Chapter 2

Planning with Personal Financial Statements

■ True/False

1. For most people, the first obstacle is to correctly assess their true net income.
Answer: False
Difficulty: Moderate
2. Salary or wages are the only cash inflows for working people.
Answer: False
Difficulty: Easy
3. Cash outflows represent your liabilities such as the pay-off on your car or home.
Answer: False
Difficulty: Difficult
4. Net cash flows are the difference between cash inflows and cash outflows and can be either positive or negative.
Answer: True
Difficulty: Easy
5. Cash inflows tend to be higher for younger individuals and lower for individuals in their 50s.
Answer: False
Difficulty: Easy
6. Individuals who switch from a low-demand industry to a high-demand industry usually earn higher incomes.
Answer: True
Difficulty: Easy
7. During the final stage in the life cycle, retirement, people experience higher incomes from their demanding careers.
Answer: False
Difficulty: Easy
8. Some people with large incomes spend their entire paychecks within a few days, while others with small incomes may be big savers.
Answer: True
Difficulty: Moderate
9. A personal cash flow statement is usually the starting point for an individual's or family's budget.
Answer: True
Difficulty: Moderate

10. 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
Difficulty: Easy
11. The most common error people make is to underestimate cash inflows and overestimate cash outflows.
Answer: False
Difficulty: Difficult
12. Detecting future cash flow overages and deficiencies in cash inflows and outflows improves with practice in the budgeting process.
Answer: True
Difficulty: Easy
13. One of the problems in making a monthly budget is that some expenses fluctuate quite a bit from month to month.
Answer: True
Difficulty: Easy
14. 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
Difficulty: Moderate
15. Getting financial help from family and friends is easy and should be one of your first options in case of emergencies.
Answer: False
Difficulty: Moderate
16. Careful budgeting and controlled spending lead to self-reliance and a feeling of financial freedom.
Answer: True
Difficulty: Easy
17. Stocks are considered liquid assets since they are easy to sell without a loss in value.
Answer: False
Difficulty: Moderate
18. Long-term liabilities are debts that will be paid at least three years into the future.
Answer: False
Difficulty: Easy
19. A high debt ratio indicates an excessive amount of debt and should be reduced over time to avoid any debt repayment problems.
Answer: True
Difficulty: Moderate
20. Your net worth can change even if your net cash flows are zero.
Answer: True
Difficulty: Difficult

■ 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

Difficulty: Moderate

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

Difficulty: Easy

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

Difficulty: Moderate

4. Which of the following is not a cash inflow?
- (a) Interest received
 - (b) Dividend income
 - (c) Car payment
 - (d) Salary

Answer: C

Difficulty: Easy

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

Difficulty: Moderate

6. Cash outflows are also called
- (a) assets.
 - (b) expenses.
 - (c) income.
 - (d) liabilities.

Answer: B

Difficulty: Easy

7. Which of the following is not a cash outflow?
- (a) Salary
 - (b) Rent
 - (c) Telephone bill
 - (d) Car payment

Answer: A

Difficulty: Easy

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

Difficulty: Moderate

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

Difficulty: Difficult

10. 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

Difficulty: Easy

11. 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

Difficulty: Moderate

12. 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

Difficulty: Easy

13. 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

Difficulty: Moderate

14. 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

Difficulty: Easy

15. 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

Difficulty: Moderate

16. 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

Difficulty: Easy

17. 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
Difficulty: Moderate
18. 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
Difficulty: Easy
19. 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
Difficulty: Moderate
20. 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
Difficulty: Moderate
21. Liquidity 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
Difficulty: Moderate

22. 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

Difficulty: Easy

23. 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

Difficulty: Moderate

24. 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

Difficulty: Moderate

25. 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

Difficulty: Easy

26. Investment assets are all of the following **except**
- (a) stocks.
 - (b) automobiles.
 - (c) bonds.
 - (d) rental property.

Answer: B

Difficulty: Easy

27. 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

Difficulty: Easy

28. 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

Difficulty: Moderate

29. Balance sheet assets should be valued at
- (a) original purchase price.
 - (b) replacement value.
 - (c) insured value.
 - (d) fair market value.

Answer: D

Difficulty: Moderate

30. 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

Difficulty: Moderate

31. 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

Difficulty: Difficult

32. 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

Difficulty: Moderate

33. 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

Difficulty: Easy

34. The difference between assets and liabilities is called

- (a) surplus.
- (b) deficit.
- (c) net income.
- (d) net worth.

Answer: D

Difficulty: Easy

35. 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

Difficulty: Easy

36. 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

Difficulty: Moderate

37. 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

Difficulty: Moderate

38. 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

Difficulty: Moderate

39. 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

Difficulty: Moderate

40. 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

Difficulty: Difficult

41. 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

Difficulty: Moderate

42. 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

Difficulty: Easy

43. 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

Difficulty: Easy

44. 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

Difficulty: Moderate

45. 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

Difficulty: Difficult

46. 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

Difficulty: Difficult

47. 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

Difficulty: Easy

48. 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

Difficulty: Moderate

49. 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

Difficulty: Difficult

50. A low liquidity ratio means
- (a) that you have very few debts.
 - (b) that liquid assests 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

Difficulty: Moderate

51. Paying cash for an Alaskan cruise would
- (a) increase assets.
 - (b) decrease assets.
 - (c) increase net worth.
 - (d) decrease liabilities.

Answer: B

Difficulty: Easy

52. 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

Difficulty: Moderate

53. 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

Difficulty: Easy

54. 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

Difficulty: Difficult

55. 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

Difficulty: Difficult

■ Fill in the Blank

- If you prepare a document that shows your cash inflows and cash outflows it is called a(n) _____.
Answer: personal cash flow statement
- A(n) _____ is a forecast of your future cash inflows and outflows.
Answer: budget
- The cash in your wallet, your checking account balance, and your savings account comprise your _____ assets.
Answer: liquid
- If your monthly disposable income equals \$1,500 and you currently save \$500/month, your savings rate is _____.
Answer: 33%
- If your net cash inflows exceed your net cash outflows, you can increase your net worth by investing the difference in more _____.
Answer: assets

■ Matching

- | | |
|-------------------------------|---|
| 1. _____ cash flow statement | (a) summary of assets, liabilities, and net worth |
| 2. _____ household assets | (b) measures cash inflows and outflows |
| 3. _____ balance sheet | (c) financial assets that can be easily sold without a loss |
| 4. _____ liquid assets | (d) property and land |
| 5. _____ bonds | (e) certificates representing partial ownership of a firm |
| 6. _____ stocks | (f) shares comprised of stocks and bonds |
| 7. _____ net cash flows | (g) the difference between cash inflows and outflows |
| 8. _____ real estate | (h) certificates issued by borrowers to raise funds |
| 9. _____ mutual funds | (i) debt paid within a year |
| 10. _____ current liabilities | (j) items owned by a household such as a home or car |

Answers:

- | | | |
|------|------|-------|
| 1. b | 5. h | 9. f |
| 2. j | 6. e | 10. i |
| 3. a | 7. g | |
| 4. c | 8. d | |

■ Essay/Short Answer

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.

2. 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.

3. 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

Answers:

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

4. 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).

■ Financial Planning Problems

1. 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: $\$200,000 - \$150,000 = \$50,000$

2. 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: $\$20,000/\$10,000 = 2$

3. 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: $\$1,000 - \$600 = \$400$

4. 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: $\$45,000 - \$22,000 = \$23,000$

5. 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: $x/\$1,000 = 3.0$
 $x = \$3,000$