Test Bank for Personal Finance Turning Money into Wealth 7th Keown

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***Personal Finance: Turning Money into Wealth, 7e* (Keown)**
Chapter 2 Measuring Your Financial Health and Making a Plan

2.1 Using a Balance Sheet to Measure Your Wealth

1) Insolvency results from earning more than you spend.
Answer: FALSE
Diff: 2
Topic: Net Worth
AACSB: Reflective Thinking

2) In some cases insolvency can lead to bankruptcy.
Answer: TRUE
Diff: 3
Topic: Net Worth
AACSB: Analytical Thinking

3) Net income is used in calculating one's net worth.
Answer: FALSE
Diff: 3
Topic: Net Worth
AACSB: Analytical Thinking

4) To calculate your net worth, subtract your total debt from your total assets.
Answer: TRUE
Diff: 2
Topic: Net Worth
AACSB: Analytical Thinking

5) According to the Keown book, the median net worth for American families in which the head of the household is less than 35 years old is below $10,000.
Answer: TRUE
Diff: 2
Topic: Net Worth
AACSB: Analytical Thinking

6) A vehicle leased in your name is an example of a tangible asset that you would list on your balance sheet.
Answer: FALSE
Diff: 2
Topic: Balance Sheet
AACSB: Analytical Thinking

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7) The house that you are leasing from a landlord is an example of a tangible asset that you would list on your balance sheet.
Answer: FALSE
Diff: 2
Topic: Balance Sheet
AACSB: Analytical Thinking

8) The term "fair market value" refers to how the price of an asset has changed since its original purchase.
Answer: FALSE
Diff: 3
Topic: Fair Market Value
AACSB: Analytical Thinking

9) Current liabilities are those that can typically be paid off in full within 12 months.
Answer: TRUE
Diff: 1
Topic: Liabilities
AACSB: Analytical Thinking

10) To determine your net worth, subtract your liabilities from your positive net equity.
Answer: FALSE
Diff: 2
Topic: Net Worth
AACSB: Analytical Thinking

11) Before you can hope to achieve your financial goals, you will need to first measure your current financial health and develop a plan and a budget.
Answer: TRUE
Diff: 1
Topic: Nothing Happens without a Plan
AACSB: Reflective Thinking

12) Planning and budgeting requires
A) control.
B) financial restraint.
C) discipline.
D) all of the above.
Answer: D
Diff: 1
Topic: Budget
AACSB: Analytical Thinking

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13) The first section of a balance sheet represents your
A) net worth.
B) financial goals.
C) assets.
D) liabilities.
Answer: C
Diff: 2
Topic: Balance Sheet
AACSB: Analytical Thinking

14) When measuring your current financial health it is important to create
A) positive net worth.
B) a personal balance sheet.
C) an income statement.
D) positive net income.
E) both B and C.
Answer: E
Diff: 2
Topic: Balance Sheet
AACSB: Analytical Thinking

15) Assets that you purchase for the purpose of accumulating wealth to satisfy your financial goals are called
A) monetary assets.
B) intangible assets.
C) investment assets.
D) all of the above.
Answer: C
Diff: 3
Topic: Balance Sheet
AACSB: Analytical Thinking

16) Liabilities are best described as
A) monetary items of value that you own.
B) financial debts and obligations that you owe.
C) your net worth.
D) assets that depreciate over time.
E) intangible obligations.
Answer: B
Diff: 1
Topic: Liabilities
AACSB: Analytical Thinking

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17) _____ can be more than or less than the price you paid for a given asset, depending on what others are willing to pay for that asset today.
A) Net value
B) Fair market value
C) Intrinsic value
D) Sentimental value
Answer: B
Diff: 3
Topic: Fair Market Value
AACSB: Analytical Thinking

18) Your _____include cash, checking and savings account balances, and money market funds.
A) monetary assets
B) tangible assets
C) physical assets
D) investment assets
Answer: A
Diff: 3
Topic: Assets
AACSB: Analytical Thinking

19) The term "fair market value" refers to
A) what an asset could be sold for today.
B) what you paid when you purchased an asset.
C) what an asset will be worth at some point in the future.
D) how the price of an asset has changed since its original purchase.
Answer: A
Diff: 2
Topic: Fair Market Value
AACSB: Analytical Thinking

20) The common thread among investment assets is that
A) they are purchased for the purpose of generating wealth.
B) they are purchased for one's personal use, like a vehicle or residence.
C) they provide the liquidity needed in case of an emergency.
D) they must be easily turned into cash with little or no loss in value.
Answer: A
Diff: 2
Topic: Assets
AACSB: Diverse and Multicultural Work Environments

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21) Your financial situation is insolvent when
A) your expenses exceed your income.
B) your assets are less than your liabilities.
C) your net worth is positive.
D) your debt ratio is too high.
Answer: B
Diff: 3
Topic: Solvency
AACSB: Analytical Thinking

22) Which of the following are not typically found on a balance sheet?
A) Monetary assets
B) Mortgage interest payments
C) Home's current market value
D) Interest earned on a CD
E) Both B and D
Answer: E
Diff: 2
Topic: Balance Sheet
AACSB: Analytical Thinking

23) Which of the following items would not be included on a balance sheet?
A) Balances owed on your utility bills
B) Balances owed on your credit card(s)
C) Mortgage payment paid
D) Automobile loan balance
E) Student loan balance
Answer: C
Diff: 2
Topic: Balance Sheet
AACSB: Analytical Thinking

24) Which financial planning document should you use to measure your current financial condition?
A) Budget
B) Cash budget
C) Balance sheet
D) Income statement
E) Statement of financial ratios
Answer: C
Diff: 2
Topic: Balance Sheet
AACSB: Analytical Thinking

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25) Items on the balance sheet that represent amounts owed to others are termed
A) assets.
B) liabilities.
C) revenues.
D) expenses.
E) none of the above.
Answer: B
Diff: 2
Topic: Liabilities
AACSB: Analytical Thinking

26) When including an asset such as a car on your balance sheet
A) list its current value as indicated in a blue book or site like www.edmunds.com.
B) list the original purchase price of the vehicle.
C) list the amount it would cost to purchase a new model of this vehicle.
D) none of the above.
Answer: A
Diff: 1
Topic: Blue Book
AACSB: Analytical Thinking

27) A physical asset such as a high-definition, flat-screen TV or a Harley Davidson motorcycle is called a(n)
A) financial asset.
B) liability.
C) tangible asset.
D) investment.
Answer: C
Diff: 2
Topic: Assets
AACSB: Analytical Thinking

28) Describe the three sections included in a personal balance sheet.
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, home mortgages, and other long term debts such as automobile loans. Your net worth, determined by subtracting liabilities from assets, is the part of your assets that are free and clear of debt.
Diff: 3
Topic: Balance Sheet
AACSB: Analytical Thinking

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29) Why is the balance sheet a useful tool?
Answer: The balance sheet is a useful tool to examine your current financial position. A financial snapshot, the balance sheet tells you how much wealth you have accumulated as of a certain date. The balance sheet also supplies the numbers for financial ratios that will help you measure your financial health against common standards.
Diff: 3
Topic: Balance Sheet
AACSB: Analytical Thinking

2.2 Using an Income Statement to Trace Your Money

1) The interest charge on your credit card statement should be listed on your personal income statement as a variable expense.
Answer: TRUE
Diff: 3
Topic: Income Statement
AACSB: Analytical Thinking

2) An income statement tracks the amount of money you have coming in and going out over some period of time, such as a month or a year.
Answer: TRUE
Diff: 1
Topic: Income Statement
AACSB: Analytical Thinking

3) Your net worth, or your general level of financial worth, is found by
A) subtracting your expenses from your income.
B) dividing your monetary assets by your current liabilities.
C) subtracting your liabilities from your assets.
D) dividing monthly debt (less a mortgage payment) by monthly income.
E) subtracting current liabilities from monetary assets.
Answer: C
Diff: 1
Topic: Net Worth
AACSB: Analytical Thinking

4) 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.
Answer: D
Diff: 2
Topic: Income Statement
AACSB: Analytical Thinking

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5) Practical uses of an income statement include
A) determining whether you are spending more than you earn.
B) spotting problem areas of overspending.
C) determining if money is available for saving or investing.
D) knowing where your money is going.
E) all of the above
Answer: E
Diff: 2
Topic: Income Statement
AACSB: Reflective Thinking

6) An expenditure over which you have no control and are obligated to make is a
A) repeating expenditure.
B) fixed expenditure.
C) constant expenditure.
D) long-term expenditure.
E) contractual expenditure.
Answer: B
Diff: 1
Topic: Expenditures
AACSB: Analytical Thinking

7) An expenditure that you can control over time and that you can manage is a(n)
A) variable expenditure.
B) fixed expenditure.
C) constant expenditure.
D) short-term expenditure.
E) adjustable expenditure.
Answer: A
Diff: 1
Topic: Expenditures
AACSB: Analytical Thinking

8) Which of the following might be found on an income statement?
A) Wages and salaries
B) Interest and dividends
C) Income taxes paid
D) Payroll taxes paid
E) All of the above
Answer: E
Diff: 2
Topic: Income Statement
AACSB: Analytical Thinking

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9) How would an income statement help you create a financial plan?
A) Spot potential areas of gambling.
B) Determines whether you are earning more than you spend
C) Determines your net worth
D) Allows you to track future income
Answer: B
Diff: 3
Topic: Income Statement
AACSB: Reflective Thinking

10) Which type of expenditure would probably be the hardest for an individual to track?
A) Credit card
B) Cash
C) Checks written
D) Automatic payments
E) Direct deposits
Answer: B
Diff: 2
Topic: Expenditures
AACSB: Reflective Thinking

11) Which of the following would be included on a personal income statement?
A) Your 401(k) balance
B) Buying a flat-screen TV on credit
C) Making a payment to your credit card company
D) All of the above
Answer: C
Diff: 3
Topic: Cash Flows
AACSB: Analytical Thinking

12) If your liabilities are greater than the value of your assets you are considered
A) unstable.
B) bankrupt.
C) insolvent.
D) unbalanced.
Answer: C
Diff: 3
Topic: Net Worth
AACSB: Analytical Thinking

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13) 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) none of the above
Answer: A
Diff: 2
Topic: Income Statement
AACSB: Analytical Thinking

14) An expenditure over which you have control and are not obligated to make, and which may vary from month to month is called a _____ expenditure.
A) fixed
B) flexible
C) liquid
D) vacillating
Answer: B
Diff: 1
Topic: Expenditures
AACSB: Analytical Thinking

15) 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) flexible
C) stationary
D) discretionary
E) none of the above
Answer: A
Diff: 1
Topic: Expenditures
AACSB: Analytical Thinking

16) Suppose that Jacob's assets include a motorcycle worth $12,000 and a checking account with a $3,000 balance, while his liabilities include a credit card balance of $4,000 and a motorcycle loan balance of $7,000. What is his net worth?
A) $4,000
B) $5,000
C) $7,000
D) $12,000
Answer: A
Diff: 2
Topic: Net Worth
AACSB: Analytical Thinking

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17) Suppose that Cathy's assets include an automobile worth $10,000 and a checking account with a $5,000 balance, while her liabilities include a student loan balance of $2,000 and a car loan balance of $8,000. What is her net worth?
A) $10,000
B) $8,000
C) $5,000
D) $2,000
Answer: C
Diff: 2
Topic: Net Worth
AACSB: Analytical Thinking

18) What would happen to your net worth if you sold a tangible asset you owned for $1,000 and used the money to pay off your credit card balance for $1,000?
A) Since your liabilities decreased, your net worth would increase by $1,000.
B) Since your assets decreased, your net worth would decrease by $1,000.
C) Your net worth would increase by $500.
D) Your net worth would remain the same.
Answer: D
Diff: 3
Topic: Net Worth
AACSB: Analytical Thinking

19) From her annual salary of $72,000, Kierstan has $5,700 automatically deducted for insurance on an annual basis. Additionally, $9,000 is deducted each year in taxes. When preparing her personal income statement, what figure should Kierstan enter for her income?
A) $66,300
B) $57,300
C) $63,000
D) $72,000
Answer: D
Diff: 3
Topic: Net Worth
AACSB: Analytical Thinking

20) From her annual salary of $60,000, Claudia has $4,500 automatically deducted for insurance on an annual basis. Additionally, $7,500 is deducted each year in taxes. When preparing her personal income statement, what figure should Claudia enter for her income?
A) $55,500
B) $48,000
C) $52,500
D) $60,000
Answer: D
Diff: 3
Topic: Net Worth
AACSB: Analytical Thinking

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21) Suppose that David'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 with $6,000 negative net worth.
E) None of the above statements are correct.
Answer: D
Diff: 2
Topic: Net Worth
AACSB: Analytical Thinking

22) Describe an income statement and its functions.
Answer: Answer: An income statement consists of three parts: income, expenses, and surplus funds. Income includes revenue from all sources and all parties contributing to the household. Typical expense items are housing, food, clothing and personal care, charitable 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. The statement is a good planning tool for budgets and income tax preparation.
Diff: 2
Topic: Income Statement
AACSB: Analytical Thinking

23) Does your use of debt affect your net worth?
Answer: Yes, although this depends on how you use credit. If you use credit to buy tangible assets like home furnishings, cars, and real estate, then you will have equity in these assets as you pay down your debt. If you use debt for daily living expenses, travel, and entertainment, then you have nothing of value to offset your debt or liabilities.
Diff: 3
Topic: Net Worth
AACSB: Analytical Thinking

24) How can an income statement help you stay solvent?
Answer: An income statement can help you stay solvent by indicating whether or not you're earning more than you spend. If you're spending too much, your income statement will show you exactly where your money is going, which will allow you to quickly spot any problem areas. If you do not spend frivolously, your income statement will indicate how much of your income is available for saving and for meeting financial goals.
Diff: 3
Topic: Income Statement
AACSB: Reflective Thinking

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2.3 Using Ratios: Financial Thermometers

1) Using financial ratios helps you quickly compare and analyze the raw data found in your personal income statement and balance sheet.
Answer: TRUE
Diff: 1
Topic: Ratios
AACSB: Analytical Thinking

2) A debt ratio is aimed at determining if you have adequate liquidity to meet emergencies.
Answer: FALSE
Diff: 1
Topic: Ratios
AACSB: Analytical Thinking

3) An emergency fund, or rainy-day fund, is comprised of liquid assets sufficient to cover 3.5 years of expenditures.
Answer: FALSE
Diff: 2
Topic: Emergency Fund
AACSB: Analytical Thinking

4) According to the Keown book, an emergency fund consists of liquid assets that are sufficient to cover _____ of expenditures.
A) 1 to 2 months
B) 3 to 6 months
C) 9 to 12 months
D) 18 to 36 months
Answer: B
Diff: 2
Topic: Emergency Fund
AACSB: Analytical Thinking

5) The purpose of using financial ratios is to
A) save space on your financial statements.
B) share your financial figures with your advisors.
C) help analyze your raw data to compare how well you are doing.
D) better understand how you are managing your financial resources.
E) both C and D.
Answer: E
Diff: 3
Topic: Ratios
AACSB: Reflective Thinking

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6) A(n) _____ is a reserve or rainy-day fund with money set aside to be used for unexpected expenses or when normal income has been disrupted.
A) emergency fund
B) umbrella fund
C) resources fund
D) risk fund
Answer: A
Diff: 2
Topic: Emergency Fund
AACSB: Analytical Thinking

7) 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) A and B
Answer: D
Diff: 2
Topic: Ratios
AACSB: Reflective Thinking

8) Your _____ is found by dividing monetary assets by current liabilities and is a good measure of liquidity.
A) debt ratio
B) current ratio
C) net worth
D) net cash flows
Answer: B
Diff: 1
Topic: Ratios
AACSB: Analytical Thinking

9) Your _____ is found by dividing total debt or liabilities by total assets.
A) debt ratio
B) current ratio
C) net worth
D) asset ratio
Answer: A
Diff: 1
Topic: Ratios
AACSB: Analytical Thinking

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10) Which of the following would you calculate if you were concerned about your financial resources with regards to unplanned money emergencies?
A) Liability ratio
B) Debt ratio
C) Long-term debt coverage ratio
D) Current ratio
E) None of the above
Answer: D
Diff: 2
Topic: Ratios
AACSB: Analytical Thinking

11) Suppose that you wanted to calculate a financial ratio to measure your liquidity. You would most 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
AACSB: Analytical Thinking

12) Suppose that you were trying to determine how much income was available for future monetary needs as well as for investments. Which of the following ratios would you most likely use?
A) Current ratio
B) Debt ratio
C) Savings ratio
D) Total asset turnover
E) None of the above
Answer: C
Diff: 1
Topic: Ratios
AACSB: Analytical Thinking

13) The current ratio is a measure of liquidity that reflects
A) how many current assets you own free and clear.
B) your debt payments for the current period.
C) how many times you can pay off your current liabilities by using your liquid assets.
D) the portion of your total liabilities that are considered current liabilities.
Answer: C
Diff: 3
Topic: Rating
AACSB: Analytical Thinking

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14) Cameron has $17,000 in monetary assets and $4,000 in current liabilities. What is his current ratio?
A) 17,000/4,000
B) .535 times
C) 5 times
D) 13,000/4,000
Answer: A
Diff: 2
Topic: Ratios
AACSB: Analytical Thinking

15) Kareem has $6000 in monetary assets and $2000 in current liabilities. What is his current ratio?
A) 2,000/6,000
B) .334 times
C) 6,000/2,000
D) 3 times
E) Both C and D are correct.
Answer: E
Diff: 2
Topic: Ratios
AACSB: Analytical Thinking

16) Alysha has $500 in monetary assets and $5,000 in current liabilities. What is her current ratio?
A) .100 percent
B) .10 times
C) 100 percent
D) 10 times
Answer: B
Diff: 2
Topic: Ratios
AACSB: Analytical Thinking

17) Henry currently has $1250 in monetary assets and also has $1250 in current liabilities. What is his current ratio?
A) 1 time
B) 100 percent
C) 1 percent
D) 0
Answer: A
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

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18) If the people below, with their respective current ratios, were to lose their jobs today, which one would have more time and more choices until he or she found another job?
A) Christy has a current ratio of 0.85 times.
B) Rick has a current ratio of 2.5 times.
C) Andrew has a current ratio of 1 time.
D) There is not enough information to answer this question.
Answer: B
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

19) Below are several people and their current ratios. If they were to lose their jobs today, which one would probably experience financial stress and pressures the quickest?
A) Elmo has a current ratio of 0.5 times.
B) Andy has a current ratio of 2.1 times.
C) Dee has a current ratio of 1 time.
D) There is not enough information to answer this question.
Answer: A
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

20) Sarah has $15,000 in monetary assets, $48,000 in annual living expenses, a $20,000 balance on her car loan, and $60,000 of equity in her house. What is her month's living expenses covered ratio?
A) 1.125 times
B) 3.75 times
C) 3.0 times
D) There is not enough information to answer this question.
Answer: B
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

21) Patty has $9,000 in monetary assets, annual living expenses of $36,000, a $12,000 car loan balance, and $45,000 in equity in her house. What is her month's living expenses covered ratio?
A) 1.125 times
B) 3.75 times
C) 3.0 times
D) There is not enough information to answer this question.
Answer: C
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

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22) Jorge has a debt ratio of 37 percent and Jose has a ratio of 102 percent. They both have the same take-home pay every month. How can we describe their current financial situation?
A) Jorge is currently solvent.
B) Jose is currently insolvent.
C) Jorge probably has more money available to enjoy every month.
D) Jose probably doesn't have much money available to enjoy every month.
E) All of the above
Answer: E
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

23) Hector's month's living expenses covered ratio is 0.25 months. He just broke his leg and will not be able to work for six weeks. Without a paycheck for six weeks, what will Hector most likely experience?
A) He may have to liquidate some of his tangible or investment assets to keep current on his monthly bills.
B) He doesn't have to worry because he has plenty of money in his savings accounts.
C) He may have to borrow some money to keep current on his monthly bills
D) There is not enough information to answer this question.
E) Both A and C are realistic possibilities.
Answer: E
Diff: 3
Topic: Ratios
AACSB: Reflective Thinking

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Tim and Autumn Davis

Tim and Autumn Davis are trying to figure out their current financial health. They will pay off their car loan in three years, their gross household income is $5,700 per month, and they receive $95 per month in interest income from their investments. They have listed the following items from their most recent statements.

Savings account: $3,200
Checking account: $1,800
Credit card balance: $3,000
Car loan balance: $18,000
Car market value: $15,000
Furniture market value: $4,000
Stocks and bonds: $15,000

24) What is their current net worth?
A) $21,000
B) $39,000
C) $18,000
D) $(21,000)
Answer: C
Diff: 3
Topic: Balance Sheet
AACSB: Analytical Thinking

25) Assuming that they have no current bills other than those that are listed, what is their current ratio?
A) 0.79 times
B) $5,000/$3,000
C) 2 times
D) Not enough information available
Answer: B
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

26) What is their debt ratio?
A) 123 percent
B) 3 times
C) 1.23 times
D) 0.54 percent
Answer: D
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

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27) What is their month's living expenses covered ratio?
A) 2 months
B) 1.23 months
C) 1.75 months
D) Not enough information to answer this question
Answer: D
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

Hector and Maria Montez

Hector and Maria Montez are trying to figure out their financial health. They will pay off their car loan in three years, their gross household income is $3,800 per month, and they receive $75 per month in interest income from their investments. They have listed the following items from their most recent statements.

Savings account: $1,200
Checking account: $800
Credit card balance: $1,000
Car loan balance: $12,000
Car market value: $8,000
Furniture; market value: $2,000
Stocks and bonds: $10,000

28) What is their current net worth?
A) $13,000
B) $22,000
C) $9,000
D) $35,000
E) $(13,000)
Answer: C
Diff: 3
Topic: Balance Sheet
AACSB: Analytical Thinking

29) Assuming that they have no current bills other than those that are listed, what is their current ratio?
A) 0.59 times
B) 2000/1000
C) 2 times
D) Both B and C are correct.
E) Not enough information available
Answer: C
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

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30) What is their debt ratio?
A) 169 percent
B) 1.69 times
C) 0.59 percent
D) 0.59 times
E) 2 times
Answer: C
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

31) What is their month's living expenses covered ratio?
A) 2 months
B) 2.44 months
C) 1.69 months
D) 0.5 months
E) Not enough information to answer this question
Answer: E
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

32) 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
AACSB: Reflective Thinking

33) How do you calculate the current ratio, debt ratio, and savings ratio?
Answer: Current ratio is calculated by dividing total current assets by total 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 investments by income available for living expenses.
Diff: 1
Topic: Ratios
AACSB: Analytical Thinking

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34) Explain the relationship between the debt ratio and insolvency?
Answer: The debt ratio shows the relationship between your assets, or how much you own, and your liabilities, or how much you owe. Your assets minus your liabilities equals your net worth. If your debt ratio is a fraction below 1.0, then your assets are larger than your debt, leaving you solvent with positive net worth. If your debt ratio is larger than 1.0, then your debt is greater than your assets, leaving you insolvent with negative net worth.
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

35) A financial ratio by itself is of little value. To what can you compare your financial ratios to make them valuable financial planning tools?
Answer: Financial ratios can be compared to historical ratios, projected or budgeted ratios, expert advice, or industry averages. If I knew my savings ratio for 2013 was 6 percent and my savings ratio for 2015 is 8 percent, then I know I have made an improvement in freeing up cash for savings and investment. If I budgeted my savings ratio for 2015 to be 10 percent and it is currently running at 8 percent, then I know I am not on track to meet my budgeted goals for the year. I can then analyze my income and expenditures to see why I am not on track to meet my goals, or possibly my goals were not realistic based on current conditions. If my savings ratio is currently 8 percent and the experts say that the ideal or average savings ratio should be 15 percent, then I can measure how well I'm doing compared to these benchmarks and adjust accordingly.
Diff: 3
Topic: Ratios
AACSB: Analytical Thinking

2.4 Record Keeping

1) According to the Keown book, Mint and Level Money are two of the best smartphone apps for tracking your spending and setting up a budget.
Answer: TRUE
Diff: 2
Topic: Budget
AACSB: Reflective Thinking

2) Which of the following is the best type of record-keeping system to use in maintaining financial records?
A) Manual method with pencil and notebook
B) Computer software
C) Apps
D) All of the above
Answer: D
Diff: 1
Topic: Record Keeping
AACSB: Reflective Thinking

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3) According the Keown book, which Web-based personal financial planning website is known as "the best free way to manage your money?"
A) Mint.com
B) Levelmoney.com
C) YahooFinance.com
D) WSJ.com
Answer: A
Diff: 3
Topic: Financial Planning
AACSB: Analytical Thinking

4) According to the Keown book, the most popular personal financial management program for the PC is
A) Intuit's Quicken.
B) MoneyGuidePro.
C) Financial Peace.
D) Crown Financial.
Answer: A
Diff: 2
Topic: Financial Planning
AACSB: Analytical Thinking

5) A strong record-keeping system allows you to
A) track expenses.
B) know exactly how much you're spending.
C) know where you're spending your financial resources.
D) all of the above.
Answer: D
Diff: 1
Topic: Record Keeping
AACSB: Analytical Thinking

6) According to the Keown book, what are the three primary reasons for maintaining financial records?
Answer: First, without adequate records, it is extremely difficult to prepare taxes. Second, a strong record-keeping system allows you to track expenses in order to know exactly how much you're spending and where you're spending it. Without that knowledge, you will not have control over your finances. Third, organized record-keeping makes it easier for someone else to step in during an emergency and understand your financial situation.
Diff: 3
Topic: Record Keeping
AACSB: Analytical Thinking

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2.5 Putting It All Together: Budgeting

1) An estimate of your anticipated after-tax income available for living expenses is commonly called take-home pay.
Answer: TRUE
Diff: 2
Topic: Expenditures
AACSB: Analytical Thinking

2) A budget is a process of setting spending goals for the upcoming month or year.
Answer: TRUE
Diff: 2
Topic: Budget
AACSB: Analytical Thinking

3) Having negative net income every once in a while is not such a bad thing as long as you have planned for it.
Answer: TRUE
Diff: 2
Topic: Income Returns
AACSB: Reflective Thinking

4) From the Keown book, you have learned that a budget
A) can be simple or sophisticated.
B) is a process of setting spending goals for the upcoming month or year.
C) is a plan for controlling cash inflows and outflows.
D) includes both actual and estimated expenses.
E) all of the above.
Answer: E
Diff: 2
Topic: Budget
AACSB: Reflective Thinking

5) Which of the following financial documents would you to 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 Planning
AACSB: Analytical Thinking

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6) Suppose that you have been operating an online marketing business out of your home, and the business has recently expanded beyond belief. Since you have neglected your personal finances for some time, what would you do as a first step?
A) Separate your personal finances from the business finances.
B) Combine your personal finances and business finances to save time.
C) Rent a separate office for your business activities.
D) Purchase a software program to handle both your business and personal finance at the same time.
Answer: A
Diff: 3
Topic: Financial Planning
AACSB: Analytical Thinking

7) A plan for controlling and forecasting your 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
AACSB: Analytical Thinking

8) Bradley went shopping today and used his American Express credit card to buy a new pullover sweater. He used his bank debit card to pay for a video game and bought some snack food with cash. Which of these purchases are difficult to track and monitor on his budget?
A) The pullover sweater is difficult to track because it costs more than what he budgeted for clothing this month.
B) The video games are difficult to track because he did not add a budget category for electronics.
C) The snacks are difficult to track because cash transactions don't leave a paper trail.
D) Both A and B
Answer: C
Diff: 2
Topic: Budget
AACSB: Analytical Thinking

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George and Betty

George and Betty, a middle-aged couple, have watched their savings account dwindle over the years. They both make good incomes and can't understand why they aren't saving more each month. Below is their financial information to complete an income statement.

Gross monthly income: $8,000
Income taxes withheld monthly: $2,300
Monthly interest income from investments: $100
Monthly insurance payments: $700
Monthly housing expenses: $4,500
Monthly food expenses: $800
Miscellaneous expenses: $400

9) What is George and Betty's net income?
A) $1,700
B) $(600)
C) $(500)
D) $1600
E) Not enough information available to answer question
Answer: B
Diff: 2
Topic: Expenditures
AACSB: Analytical Thinking

10) What is their current savings ratio?
A) 10.3 percent
B) negative 10.3 percent
C) zero
D) None of the above
Answer: B
Diff: 2
Topic: Ratios
AACSB: Analytical Thinking

11) George and Betty ask you for financial advice. What would you tell them to do?
A) They should hire a Certified Financial Planner to assist them.
B) Nothing. With their income they are in good shape financially.
C) They need to live within their means.
D) Both A and C would be good advice for them.
Answer: D
Diff: 1
Topic: Record Keeping
AACSB: Analytical Thinking

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12) 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
AACSB: Analytical Thinking

13) Describe 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. From the appropriate paycheck or source of income, allocate the proper amount of money for each envelope. Use the money in each envelope only for its intended use, and you should have enough to go around. As soon as possible, add an envelope for savings and emergencies.
Diff: 3
Topic: Financial Planning
AACSB: Analytical Thinking

14) What are some benefits of using a mobile app coupled with a Web-based personal financial planning website? Which two websites/apps are highly recommended by the author?
Answer: Many personal financial planning apps and websites allow you to keep an eye on your financial moves. Several allow you to simultaneously track all bank accounts, credit cards, retirement accounts, investments, and loans. Mint.com, a free app and website, is one such tool. It also allows you to create a budget based on your actual spending and helps you plan for your financial goals. Another example is Levelmoney.com. Free, simple, and effective, Level Money works like a gas gauge, monitoring your spending and keeping you from getting into financial trouble. Both Mint.com and Levelmoney.com are highly recommended by the author.
Diff: 3
Topic: Financial Planning
AACSB: Information Technology

2.6 Hiring a Professional

1) Commission-only planners charge fees and collect commissions on products they recommend.
Answer: FALSE
Diff: 1
Topic: Probate
AACSB: Reflective Thinking

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2) 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
AACSB: Reflective Thinking

3) _____ planners charge a fee that is reduced by the amount of the commissions they earn.
A) Fee-only
B) Fee-and-commission
C) Fee-offset
D) Commission-based
Answer: C
Diff: 2
Topic: Professional Financial Planners
AACSB: Analytical Thinking

4) Which of the following is a relevant question to ask a financial planner?
A) What are your credentials and professional designations?
B) Would you provide us with references?
C) Would you show us a similar financial plan you have done for someone else?
D) Will you provide us with a written estimate of your services and their cost?
E) All of the above
Answer: E
Diff: 3
Topic: Professional Financial Planners
AACSB: Reflective Thinking

5) Under what conditions should people hire a professional financial planner?
A) When they need someone to improve or validate the plan they prepared themselves
B) When they start receiving late payment penalties from their creditors
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
AACSB: Reflective Thinking

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 compile the entire plan together for you. If you develop your own plan, you might want a professional planner to validate what you have done.
Diff: 2
Topic: Financial Planning
AACSB: Reflective Thinking

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7) 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 created for someone else in similar circumstances?
7. Who will work with you on my plan? Will the work be done by a junior staffer or a computer program?
9. Are you paid through fees, commissions, or a combination? What are your fees and commissions, how often are you paid, and how will your fees and commissions 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
AACSB: Reflective Thinking

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. From an objective point of view, the pro will be able to help you prepare balance sheets, income statements, budgets, and financial ratios, as well as savings, investment, and retirement plans that are realistic. A financial planner can save you time and costly mistakes. He or she may suggest a computer software program to meet your individual needs, as well as give tax advice.
Diff: 2
Topic: Professional Financial Planners
AACSB: Reflective Thinking

9) The experts say that, stereotypically, a fee-only financial planner is a better option than one who earns commissions on what he or she sells you. Why is this sometimes true?
Answer: Because of the agency relationship and self-interested behavior, a commission-earning financial planner may be more interested in the commissions he or she will earn versus what is best for your personal needs. There is the potential for the planner to recommend financial products that pay higher commissions, when these products may not be best suited to your individual needs, or when there may be less expensive options available. A fee-only planner has no such incentive, since the fees are not contingent on your financial decisions. The fee-only planner knows that he or she must do a good job or you will not continue to utilize their services or refer new business to them.
Diff: 3
Topic: Financial Planning
AACSB: Reflective Thinking

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