

Personal Finance, 6e (Madura)

Chapter 21 Integrating the Components of a Financial Plan

21.1 Review of Components Within a Financial Plan

1) Budgeting allows you to forecast how much money you will have at the end of each month so that you can determine how much you will be able to invest in assets.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) Careful budgeting lets you spend more to achieve your short-term financial goals.

Answer: FALSE

Diff: 2

Question Status: Previous edition

3) The more you spend, the less money you will have available for liquidity purposes or to make investments or to save for retirement.

Answer: TRUE

Diff: 1

Question Status: Previous edition

4) Budgeting decisions involve a tradeoff between spending today and allocating funds for the future.

Answer: TRUE

Diff: 1

Question Status: Previous edition

5) If you have enough liquidity, you should either obtain short-term financing or sell assets.

Answer: FALSE

Diff: 1

Question Status: Previous edition

6) You should maintain just enough money in liquid assets to satisfy your liquidity needs then you can earn a higher return on your other assets.

Answer: TRUE

Diff: 2

Question Status: Revised

7) Personal financing can be beneficial because it allows you to make purchases now without the full amount of cash on hand.

Answer: TRUE

Diff: 1

Question Status: Revised

8) Loans restrict your spending or saving in future months and, therefore, can prevent you from achieving financial goals.

Answer: TRUE

Diff: 2

Question Status: Previous edition

9) The idea of having adequate insurance is to protect against events that could reduce your income or wealth.

Answer: TRUE

Diff: 1

Question Status: Previous edition

10) It is not possible to have too much insurance coverage.

Answer: FALSE

Diff: 1

Question Status: Previous edition

11) There is a cost/benefit relationship for insurance protection which means you could be under-insured or over-insured.

Answer: TRUE

Diff: 1

Question Status: Previous edition

12) Investing in stocks of large, well-known firms may enhance your liquidity, but typically these investments do not generate as high a return as stocks of smaller firms.

Answer: TRUE

Diff: 2

Question Status: Previous edition

13) Stocks of smaller firms are more volatile than those of larger firms and, therefore, are not as liquid.

Answer: TRUE

Diff: 1

Question Status: Previous edition

14) You should make investments only after you have sufficient liquidity and sufficient insurance to protect your existing assets.

Answer: TRUE

Diff: 2

Question Status: Previous edition

15) You may want to make additional loan payments to pay off your loan faster if the interest rate you are paying is higher than you could obtain from an investment.

Answer: TRUE

Diff: 1

Question Status: Revised

16) One disadvantage of investing in retirement accounts is that these funds are typically not very liquid.

Answer: TRUE

Diff: 1

Question Status: Previous edition

17) Some retirement plans, such as Roth IRAs, are more liquid than other plans.

Answer: TRUE

Diff: 1

Question Status: Previous edition

18) To monitor your financial plan over time, it is important to store finance-related documents in a safe and accessible place.

Answer: TRUE

Diff: 1

Question Status: Previous edition

19) A budget is **not** intended to help you determine

A) how much money you will have at the end of each month.

B) a plan for spending all of your income on current needs.

C) how much you can allocate for the future.

D) how to prevent excessive spending to achieve financial goals.

Answer: B

Diff: 1

Question Status: Previous edition

20) Which of the following best explains why some consumers have difficulty creating and sticking to a budget?

A) They don't make enough money.

B) They can't determine their cash outflows.

C) They spend excessively due to the need for immediate satisfaction.

D) They have difficulty making decisions about their financing.

Answer: C

Diff: 1

Question Status: Revised

21) Which component of a financial plan affects all the other components of the financial plan?

A) Budgeting

B) Retirement planning

C) Investing

D) Estate planning

Answer: A

Diff: 1

Question Status: Revised

22) Liquid assets usually generate

- A) high returns.
- B) returns like stocks.
- C) returns like bonds.
- D) lower returns.

Answer: D

Diff: 2

Question Status: Previous edition

23) Your liquid assets do **not** include your

- A) bank account balances.
- B) money market securities.
- C) certificates of deposit.
- D) bond mutual funds.

Answer: D

Diff: 2

Question Status: Revised

24) Purposes of managing liquidity include all of the following **except**

- A) determining how to keep the majority of your assets in liquid form.
- B) having enough liquid assets to cover cash shortages.
- C) maintaining adequate liquidity to avoid borrowing every time you need money.
- D) maintaining just enough liquid assets to meet your needs.

Answer: A

Diff: 1

Question Status: Revised

25) Which of the following assets will **not** increase your liquidity?

- A) Checking account
- B) Money market mutual fund
- C) Cash in a traditional IRA
- D) Cash in your wallet

Answer: C

Diff: 1

Question Status: Revised

26) Personal financing can do all of the following, **except**

- A) allow you to make purchases without having the full amount of cash on hand.
- B) increase the amount of your assets.
- C) prove useful for large purchases.
- D) help in increasing your ability to save.

Answer: D

Diff: 1

Question Status: Revised

27) One advantage of financing with a mortgage or using a home equity loan is that the interest payments are

- A) at below market rates.
- B) tax-deductible.
- C) an asset.
- D) the largest part of the payment.

Answer: B

Diff: 1

Question Status: Revised

28) One disadvantage of financing is

- A) interest payments are tax-deductible.
- B) it allows you to make purchases without having adequate cash available.
- C) it can cause budgeting problems.
- D) it allows you to have more money in the future.

Answer: C

Diff: 1

Question Status: Previous edition

29) A home equity loan may do all of the following **except**

- A) give you a tax deduction if you itemize.
- B) increase your current purchasing power.
- C) increase your spending in the future.
- D) prevent you from achieving your financial goals.

Answer: C

Diff: 2

Question Status: Previous edition

30) Which of the following statements is **not** true?

- A) You should use all of your liquid assets to pay off loans.
- B) Paying off loans is appropriate when the interest rate is relatively high.
- C) Paying off loans is wise when the expected rate you will earn on investments is lower than the interest rate on the loan.
- D) Loan payments you make restrict your spending and saving and may prevent you from achieving financial goals.

Answer: A

Diff: 2

Question Status: Revised

31) Monitoring financing includes evaluating all of the following balances **except**

- A) credit cards.
- B) mortgage loans.
- C) personal loans.
- D) Roth IRA.

Answer: D

Diff: 1

Question Status: Previous edition

32) The purpose of insurance is to protect your

- A) liabilities and expenses.
- B) assets and liabilities.
- C) assets and net worth.
- D) income and expenses.

Answer: C

Diff: 1

Question Status: Previous edition

33) Which of the following statements about insurance is **not** true?

- A) It protects you from events that could reduce your wealth.
- B) Money used to buy insurance is not available for investing.
- C) You cannot have too much insurance.
- D) All of the above are true about insurance.

Answer: C

Diff: 1

Question Status: Previous edition

34) If you own personal property, which type of insurance are you most likely to budget for first?

- A) Property and casualty insurance
- B) Disability insurance
- C) Health insurance
- D) Flood insurance

Answer: A

Diff: 1

Question Status: Previous edition

35) _____ insurance provides financial support if you are injured and unable to work.

- A) Liability
- B) Disability
- C) Compensatory
- D) Medical reimbursement

Answer: B

Diff: 2

Question Status: Revised

36) Insurance protects against events that could reduce

- A) your income.
- B) your chances of an accident.
- C) your wealth.
- D) Both A and C are correct.

Answer: D

Diff: 1

Question Status: Previous edition

37) Which of the following should you do first?

- A) Invest in liquid assets
- B) Pay off loans
- C) Buy insurance
- D) Make investments

Answer: C

Diff: 2

Question Status: Previous edition

38) Which of the following investments achieves the greatest diversification?

- A) Stocks
- B) Bonds
- C) Mutual funds
- D) Savings accounts

Answer: C

Diff: 1

Question Status: Previous edition

39) If you want periodic income, which of the following investments should you purchase?

- A) Bonds
- B) Stocks that pay cash dividends
- C) Mutual funds
- D) Both A and B are correct

Answer: D

Diff: 1

Question Status: Previous edition

40) If you are a high-income individual, you should **not** invest in

- A) stocks that pay cash dividends.
- B) growth stocks.
- C) municipal bonds.
- D) global mutual funds.

Answer: A

Diff: 1

Question Status: Previous edition

41) By investing in stock of _____, _____ firms, you may enhance your liquidity because you will receive dividend income.

- A) small; well-known
- B) small; unknown
- C) large; unknown
- D) large; well-known

Answer: D

Diff: 1

Question Status: Previous edition

42) If you are on a limited fixed income, you should **not** invest in

- A) bonds.
- B) stocks that pay cash dividends.
- C) growth stocks.
- D) certificates of deposit.

Answer: C

Diff: 1

Question Status: Revised

43) Compared to the stocks of larger firms, the stocks of smaller firms are

- A) less volatile.
- B) more volatile.
- C) more liquid.
- D) safer.

Answer: B

Diff: 1

Question Status: Previous edition

44) If your goal is to save for retirement, which of the following investments would you **not** consider?

- A) 401(k) plan
- B) Traditional IRA
- C) Profit-sharing plan
- D) Intermediate term certificate of deposit

Answer: D

Diff: 1

Question Status: Revised

45) Key documents for managing investments include all of the following **except**

- A) retirement plan balances.
- B) account balance showing the market value of mutual funds.
- C) insurance policies.
- D) stock certificates.

Answer: C

Diff: 2

Question Status: Revised

46) Financial documents should be

- A) kept in a desk drawer in your home for easy access.
- B) kept in a safety deposit box.
- C) kept at your parents' house in their desk.
- D) None of the above.

Answer: B

Diff: 2

Question Status: Revised

47) Which of the following key documents should **not** be kept in a safety deposit box?

- A) The only copy of your will
- B) Your monthly bank statement
- C) Original copies of life insurance policies
- D) Deed to your house

Answer: B

Diff: 2

Question Status: Previous edition

48) As a result of the _____, the more you spend the less money you will have for liquidity or investments.

Answer: budget tradeoff

Diff: 1

Question Status: Previous edition

49) It is easier to make monthly loan payments if you select financing that has relatively _____ maturities.

Answer: long

Diff: 1

Question Status: Previous edition

50) You should invest in _____ if you need periodic income.

Answer: bonds or dividend paying stocks

Diff: 1

Question Status: Previous edition

51) _____ is a means of protecting your assets and income.

Answer: Insurance

Diff: 1

Question Status: Previous edition

52) _____ should be kept in a safe at home or in a safety deposit box at a bank.

Answer: Financial documents

Diff: 1

Question Status: Previous edition

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

- A) asset and income protection
- B) a place to store your financial documents
- C) a loan to purchase a home or condominium
- D) amount saved for the future

53) mortgage loan

Diff: 1

Question Status: New

54) insurance

Diff: 1

Question Status: New

55) safety deposit box

Diff: 1

Question Status: New

56) retirement account

Diff: 1

Question Status: New

Answers: 53) C 54) A 55) B 56) D

57) List five areas that affect your financial plan.

Answer: Budgeting, managing liquidity, financing, investing, protecting your wealth and retirement and estate planning.

Diff: 1

Question Status: Revised

58) Name three ways to protect and maintain your wealth and assets and maintain your standard of living.

Answer: Insurance policies, diversification of investments, maintaining enough liquid assets to cover a cash shortage, and retirement planning are possible answers.

Diff: 1

Question Status: Revised

59) What are three types of financing you have studied?

Answer: Credit cards, personal loans, mortgages and home equity loans and lines of credit are possible answers.

Diff: 1

Question Status: Revised

60) Maintaining a "rainy day fund" is another way of making sure you have adequate

- A) liquidity.
- B) life insurance.
- C) property insurance.
- D) foul weather gear.

Answer: A

Diff: 1

Question Status: New

61) To ensure adequate liquidity for a rainy day fund, you should keep those funds in

- A) high quality stocks.
- B) municipal bonds to minimize federal taxes.
- C) money market fund accounts.
- D) gold since it can be a storehouse of value.

Answer: C

Diff: 2

Question Status: New

62) One disadvantage of financing a new car with a 15 year home equity loan is

- A) the interest is tax deductible.
- B) the interest is not tax deductible.
- C) you are mismatching the asset life with the term of the loan.
- D) There are no disadvantages of borrowing on a home equity loan.

Answer: C

Diff: 3

Question Status: New

63) When you borrow on a mortgage to buy a new home, the lender will require you to purchase

- A) life insurance.
- B) homeowner's insurance.
- C) disability insurance.
- D) the lender will require you to purchase all three types of insurance to protect their loan.

Answer: B

Diff: 2

Question Status: New

64) You have a car loan at a 8% per year interest, school loans averaging 3% per year interest, credit card debt at 14% per year interest, and you are investing in a fund in which you are earning 7% per year. If you have excess cash flow of \$200 per month, prioritize where you should make accelerated payments or invest the cash to optimize the financial result.

- A) Credit card debt, car loan, investment, school loan
- B) Investment, car loan, school loan, credit card debt
- C) Investment, school loan, credit card debt, car loan
- D) Always put excess cash to use in an investment

Answer: A

Diff: 2

Question Status: New

21.2 Integrating the Components

1) Most people set financial goals early in life and these goals rarely change.

Answer: FALSE

Diff: 1

Question Status: Previous edition

2) As time passes, your financial position and goals are likely to change so you will need to revise your financial plan.

Answer: TRUE

Diff: 1

Question Status: Previous edition

3) Which of the following does **not** increase your net worth?

A) An increase in your retirement balance

B) An increase in your home value

C) An increase in your mutual funds

D) The purchase of a new car

Answer: D

Diff: 1

Question Status: Previous edition

4) To increase your net worth you should

A) pay off bills.

B) spend your money carefully.

C) invest in appreciating assets.

D) Both A and C are correct.

Answer: D

Diff: 1

Question Status: Previous edition

5) Which of the following will **not** improve your net worth?

A) Increasing your income

B) Decreasing your expenses

C) Increasing your assets

D) Increasing your liabilities

Answer: D

Diff: 2

Question Status: Revised

6) Which of the following will increase your net worth over time?

- A) Leasing a car
- B) Renting a house
- C) Buying a house
- D) All of the above.

Answer: C

Diff: 1

Question Status: Previous edition

7) You are 25 years old and saving for an early retirement. Assuming you have a high risk tolerance, which of the following can best help you reach your goal of retiring early?

- A) Municipal bond fund
- B) Money market securities
- C) Common stock
- D) Certificates of deposit

Answer: C

Diff: 1

Question Status: Revised

8) If you save monthly for retirement, which of the following would be used to determine how much you would ultimately have in your retirement account?

- A) Present value of an annuity
- B) Future value of an annuity
- C) Present value of \$1
- D) Standard deviation

Answer: B

Diff: 2

Question Status: Previous edition

9) Which of the following investments generally reduces pre-tax income?

- A) Stocks
- B) Retirement account contributions
- C) Mutual funds
- D) Bonds

Answer: B

Diff: 1

Question Status: Revised

10) What is the disadvantage of investments in retirement accounts compared to other investments?

- A) Low returns
- B) Low liquidity
- C) High risk
- D) Low risk

Answer: B

Diff: 2

Question Status: Revised

11) In deciding how much to contribute to your retirement account, which of the following should you least consider?

- A) Anticipated inheritances
- B) Other financial goals
- C) Liquidity needs
- D) Current expenses

Answer: A

Diff: 1

Question Status: Revised

12) Even average people can accumulate wealth by

- A) spending less than they make.
- B) spending more than they make.
- C) following hot investment tips found on the Internet.
- D) playing the lottery.

Answer: A

Diff: 1

Question Status: Revised

13) Financial statements include all of the following **except** a(n)

- A) balance sheet.
- B) income statement.
- C) cash flow statement.
- D) asset allocation statement.

Answer: D

Diff: 1

Question Status: Previous edition

14) You are single and live in a furnished apartment. Which of the following are you most likely to need?

- A) Stockbroker
- B) Life insurance
- C) A will
- D) A budget

Answer: D

Diff: 2

Question Status: Previous edition

15) Key documents for managing personal financing include all **except**

- A) credit card statements.
- B) retirement account balances.
- C) personal loans, such as automobile loans.
- D) mortgage loan agreement.

Answer: B

Diff: 1

Question Status: Previous edition

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

- A) home, car, furniture
- B) stocks, bonds and mutual funds
- C) planning for insurance, investing, financing, and retirement
- D) amounts owed that are due in less than one year
- E) cash, checking account, and money market account
- F) assets less liabilities

16) liquid assets
Diff: 1
Question Status: New

17) investments
Diff: 1
Question Status: New

18) current liabilities
Diff: 1
Question Status: New

19) net worth
Diff: 1
Question Status: New

20) household assets
Diff: 1
Question Status: New

21) financial plan
Diff: 1
Question Status: New

Answers: 16) E 17) B 18) D 19) F 20) A 21) C

22) What are four types of financial investment balances that you should monitor?
Answer: Market value of stocks, bonds, mutual funds, retirement accounts, checking and savings accounts.
Diff: 1
Question Status: Previous edition

- 23) The key factor to be considered before investing in municipal bonds is
- A) they are financially advantageous mainly to high tax rate investors.
 - B) they are generally not as liquid as high grade corporate bonds.
 - C) in order to diversify you should invest in a municipal bond fund rather than specific bonds.
 - D) All of the above are key considerations.

Answer: D

Diff: 3

Question Status: New

- 24) The easiest way to begin investing and building wealth is by
- A) inheriting from your grandparents.
 - B) buying high growth stocks early and often.
 - C) spending less than you make and invest excess cash flow on a routine monthly basis.
 - D) investing in high yield bonds.

Answer: C

Diff: 2

Question Status: New

- 25) A term life policy is the least expensive way to
- A) build a big estate when you die.
 - B) insure your life and provide for your responsibilities in the event of unexpected death.
 - C) save for your retirement years as the policy builds cash value.
 - D) insure your health, ability to work and your life all in one policy.

Answer: B

Diff: 1

Question Status: New

21.3 Financial Plan

1) A financial plan should be

- A) prepared when you graduate from college and carefully followed thereafter without changes.
- B) prepared when you graduate from college and carefully followed until you retire when you will no longer need one.
- C) prepared when you graduate from college and reviewed/adjusted as events such as marriage, job changes, birth of children, and retirement necessitate.
- D) prepared only in a rough outline as it will change too often to make anything more detailed feasible.

Answer: C

Diff: 1

Question Status: Revised

2) The purpose of financial planning is to help do all of the following **except**

- A) set goals.
- B) increase your spending.
- C) become financially educated.
- D) increase wealth or net worth.

Answer: B

Diff: 1

Question Status: Previous edition

3) Bill and Jan are reviewing their current financial plan. They have decided that it is time obtain life insurance and begin contributing to an investment fund for college. Bill and Jan are

- A) a young, dual-income couple with no children.
- B) young and single.
- C) a young couple with children under the age of 18.
- D) an older couple with no dependent children living at home.

Answer: C

Diff: 1

Question Status: Previous edition

4) Matt is 25 and wants to save \$2,000 per year in an IRA until he retires at age 65. If Matt's investment earns 9%, how much will his IRA be worth when he retires?

- A) \$64,030
- B) \$579,471
- C) \$272,620
- D) \$675,780

Answer: D

Explanation: D) FVIFA, 9%, 40 years: $337.890 \times \$2,000 = \$675,780$

Diff: 1

Question Status: Revised

5) Mary Kay has a child who will start college in 10 years. She plans to set aside \$2,400 per year for her child's education during this period and estimates she will earn an annual rate of 8%. How much will Mary Kay have available for her child's education in 10 years?

- A) \$24,000
- B) \$27,446
- C) \$34,769
- D) \$29,971

Answer: C

Explanation: C) FVIFA, 8%, 10 years: $14.487 \times \$2,400 = \$34,769$

Diff: 1

Question Status: Previous edition

6) Don wants to have \$50,000 available in 10 years for retirement living expenses and health care. If he earns an average of 8% on his investments, what amount must he invest each year?

- A) \$3,453
- B) \$5,000
- C) \$4,372
- D) \$4,003

Answer: A

Explanation: A) $\$50,000/14.487$ (FVIFA) = \$3,453

Diff: 1

Question Status: Previous edition

7) Assume that you set aside \$500 per year, and invest that money over the next five years in an account earning 6%. What is the amount of interest you will earn on this investment?

- A) \$300
- B) \$319
- C) \$263
- D) \$250

Answer: B

Explanation: B) FVIFA, 6%, 5 yrs : $5.637 \times \$500 = \$2,819$; $\$2,819 - \$2,500 = \$319$

Diff: 1

Question Status: Revised

8) Louie just got a big raise and wants to begin investing his excess cash flow. If he invests \$7,500 per year for the next 30 years, and earns 5% on his investments, how much money will he have when he is nearing retirement?

- A) \$385,567
- B) \$500,000
- C) \$498,291
- D) \$265,987

Answer: C

Diff: 1

Question Status: New

9) As you prepare your financial plan and revise it from year to year, it would be prudent to plan for how much money it will take to

A) buy your dream house and dream car.

B) live out your retirement years in the same standard of living you had while working.

C) retire at 45 years of age.

D) You may find yourself planning for any or all of the objectives in A-C.

Answer: D

Diff: 1

Question Status: New