Personal Finance (Canadian) 5th edition Madura Test Bank

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TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

1) Many people who believe they have strong personal finance skills do not really understand some basic personal finance concepts.
Answer: True False

2) FP Canada sets out the steps needed to earn the Certified Financial Planner (CFP) designation.
Answer: True False

3) A car accident which is not fully covered by your insurance is an example of an unexpected expense you cannot plan for.
Answer: True False

4) An understanding of personal finance is necessary to judge the quality of advice that a financial adviser may give.
Answer: True False

5) FP Canada is a profit–oriented organization created to benefit the public with regards to financial planning.
Answer: True False

6) Saving money for the downpayment on a house instead of saving for retirement is an example of an opportunity cost.
Answer: True False

7) Generally, savings in an emergency fund will tend to earn higher interest than savings in a retirement plan.
Answer: True False

8) If you have sufficient available credit there is no reason to consider holding liquid cash in an emergency fund.
Answer: True False

9) As long as you stay within your budget of spending $100 per month on eating out, there is no opportunity cost.
Answer: True False

10) Taxes should have a minimal impact on your financial choices.
Answer: True False

11) Risk management may include deciding not to protect yourself against a given risk.
Answer: True False

12) The historical average for the household savings rate is 3.2 percent.
Answer: True False

13) From 2000 to 2018, the level of household debt relative to disposable income has decreased from 174.9 percent to 106.9 percent.
Answer: True False

14) The delinquency rate on 90–day non–mortgage debt rose 3.5 percent to 1.12 percent in the first quarter of 2019.
Answer: True False

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MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

15) Which of the following best describes the level of debt for Canadians?
A) From 2000 to 2018 household debt relative to disposable income has increased from 106.9 percent to 174.9 percent.
B) As of January 2020 the per capita debt of Canadians is $48,829.
C) The outstanding balance on credit cards has never exceeded $100 billion.
D) The household savings rate has been above the historical average since late 2015.

Answer: A

16) Which of the following life stages involves the fewest objectives and milestones?
A) Education B) Prime earning C) Early career D) Late retirement

Answer: A

17) Opportunity cost represents
A) the non–financial cost of any opportunity.
B) short– versus long-term financial decisions.
C) the financial cost of any opportunity.
D) what you give up as a result of making a decision.

Answer: D

18) An emergency fund is required in financial planning to
A) maintain adequate liquidity. B) eliminate risk.
C) maintain your standard of living. D) maintain credit rating.

Answer: A

19) John earns $3000 monthly income and he decides to set aside 10 percent as savings. In his savings, John wants to reserve 20 percent in his emergency fund. What amount would John accumulate in his emergency fund annually?
A) $360 B) $720 C) $600 D) $300

Answer: B

20) Credit is commonly used to cover both large and small expenses. What is the best way to think about credit?
A) It is an important part of liquidity but needs to be managed.
B) It is a better source of liquidity than an emergency fund.
C) It should never be used for liquidity.
D) Most Canadians do a good job managing credit compared to other G7 countries.

Answer: A

21) Which of the following is an example of an opportunity cost?
A) Saving money instead of taking a vacation
B) Saving for an emergency fund instead of maximizing your RRSPs
C) Renting an apartment near school instead of living with your parents
D) They are all examples of opportunity cost.

Answer: D

22) Which of the following would **not** be a factor in evaluating your current financial position?
A) Expenses B) Income C) Assets D) Budgeting

Answer: D

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23) As of January 2020, the per capita debt of Canadians has increased to
A) $8 829. B) $28 829. C) $18 829. D) $38 829.
Answer: C

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

24) Explain four sources from which you could obtain assistance with your financial plan and identify any areas of caution you should observe while accepting such advice.
Answer: Possible options:
1. Financial planner: potential conflict of interest, driven by commissions
2. Bank adviser: only able to sell in-house product or incompetent advice
3. Investor education websites: dedicated to improve investor know-how, make sure it is legitimate and get a second opinion before following any online advice
4. Financial institution websites: watch for conflict of interest, bias, can be useful for certain calculations etc.
5. Government agency websites: generally safe but limited to general recommendations
6. Referrals from friends: ask critical questions

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

25) A complete financial plan consists of budgeting, tax planning, financing, and investing.
Answer: True False

26) The first step in budgeting is to evaluate your current financial position by determining your total assets and total liabilities.
Answer: True False

27) The value of what you own minus the value of what you owe is called your "net assets."
Answer: True False

28) During the "education" life stage it is important to establish good investing habits.
Answer: True False

29) Using a credit card to cover an unexpected expense is an example of using an emergency fund.
Answer: True False

30) Money management decisions include deciding how much money to contribute to long term retirement savings.
Answer: True False

31) Your financial plan should include a plan for protecting your assets and income through insurance coverage.
Answer: True False

32) An emergency fund contains the portion of savings that you have allocated to long-term needs.
Answer: True False

33) One of the considerations in determining your investment choices is evaluating the level of risk you are willing to take.
Answer: True False

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34) Most people act in a logical fashion when implementing a financial plan.

Answer: True False

35) There are four key steps in developing a financial plan: 1. Establishing goals; 2. Selecting the best options to reach your goals; 3. Comparing your plan to the plans of other people; and 4. Revising your plan annually.

Answer: True False

36) Saving too much for short–term needs does not limit your opportunity for long–term growth.

Answer: True False

37) Future spending decisions are less relevant to your financial success than past spending decisions.

Answer: True False

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

38) The correct order of the key components of a financial plan is

A) budgeting and tax planning, managing your financial resources, protecting your assets and income, investing your money, planning your retirement and estate.

B) investing you money, managing your financial resources, protecting your assets and income, budgeting and tax planning, planning your retirement and estate..

C) budgeting and tax planning, protecting your assets and income, managing your financial resources, investing your money, planning your retirement and estate.

D) managing your financial resources, protecting your assets and income, budgeting and tax planning, investing your money, planning your retirement and estate.

Answer: A

39) Which of the following is an example of investment risk in financial planning?

A) Loss of capital in a particular mutual fund

B) Loss of property by not buying insurance

C) Loss of income due to short–term disability

D) Loss of liquidity by locking in to a fixed–term deposit

Answer: A

40) Which of the following financial planning steps should occur during the "prime earning" life stage?

A) Creating a will and power of attorney B) Investigate employer–based savings options

C) Paying off all debts D) Estate planning

Answer: C

41) What is the process of forecasting future expenses and savings called?

A) Predicting B) Forecasting C) Budgeting D) Planning

Answer: C

42) Which of the following is a decision that you would make during estate planning?

A) How to enhance your net worth

B) How much money you should allocate to retirement plans

C) How you will maximize taxation and probate

D) How your wealth will be distributed before and after your death

Answer: D

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43) Budgeting helps set goals by estimating on a monthly basis which of the following?
A) Net worth and income
B) Income and expenses
C) Liabilities and expenses
D) Assets and income

Answer: B

44) What is first step in budgeting?
A) Assessing your current financial position
B) Establishing good money management habits
C) Establishing a good credit rating
D) Determining your net worth

Answer: A

45) What is the best way to describe liquidity?
A) Access to ready cash
B) Positive cash flow
C) Access to credit
D) Effective money management

Answer: A

46) Which of the following is the best description of money management?
A) Decisions regarding how much credit to have available in combination with liquid savings
B) Decisions regarding how much money to retain in liquid form and short–term investing decisions
C) Decisions regarding how much money to retain in total and long–term investing decisions
D) Decisions regarding what to do with surplus income over expenses on a monthly basis

Answer: B

47) Which of the following best describes how credit should be used?
A) Credit should be used at any time as long as you are able to make the minimum monthly payments.
B) Credit should be used at any time as long as it can be repaid in full within 90 days.
C) Credit should never be used under any circumstances.
D) Credit should be used only when necessary since you must repay borrowed funds with interest.

Answer: D

48) What is the best measure of a person's or family's net wealth?
A) The amount of annual income less applicable taxes
B) The value of their assets
C) The value of what they own minus the value of what they owe
D) The value of their gross income minus the value of their expenses

Answer: C

49) Your current net worth will be increased by which of the following actions?
A) Receiving a $500 birthday present from your grandmother
B) Using $350,000 you have in savings to purchase a rental property
C) Changing your monthly savings from 15 percent to 10 percent of your earnings
D) Buying a new stereo system and putting the entire amount on your credit card

Answer: A

50) Which of the following should first be used to cover any short–term cash deficiencies?
A) A line of credit
B) An interest free loan from family or friends
C) A cashable short–term investment
D) Retirement savings

Answer: C

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51) Which of the following will **most** affect your ability to manage your liquidity?
A) Determining which short–term investments to keep your emergency fund in
B) Determining how much money to save versus how much to spend
C) Owning versus renting a home
D) Choosing between a high–interest and a low–interest credit card

Answer: B

52) What is the term used to describe decisions on how much credit you need to support spending and which sources of credit to use?
A) Investment management
B) Liquidity management
C) Credit management
D) Money management

Answer: C

53) Which of the following is a credit management decision?
A) Obtaining a student loan to attend college or university
B) Putting money into short-term investments
C) Purchasing a used car with cash
D) Putting money into an emergency fund

Answer: A

54) Which of the following is an example of money management?
A) Deciding to delay buying a car until you can pay for it with cash
B) Shopping around for the credit card with the best interest rate
C) Putting your money in a savings account at your bank
D) Purchasing life insurance to protect your spouse should you pass away

Answer: C

55) Under which component of a financial plan would the following decision fall: determining how much you can afford to borrow, the length of the loan, and appropriate interest rate, when considering how to afford your car purchase?
A) Credit management
B) Financing
C) Budgeting
D) Liquidity

Answer: B

56) In the early career life stage of financial planning, which of the following is the most important to address?
A) Paying off student loans and short–term debts
B) Considering when to get married
C) Maintaining job security
D) Saving for a child's future education

Answer: A

57) John is in the family and mid–career life stage of financial planning. Which of the following is most important for John to address?
A) Establishing a credit rating
B) Reviewing insurance needs
C) Paying off student loans
D) The pay yourself first principle

Answer: B

58) Usually, people should first consider having a will and power of attorney in which life stage of financial planning?
A) Early retirement
B) Prime earning
C) Mid career
D) Early career

Answer: C

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59) Which of the following is included in risk management?
A) Deciding whether to rent or buy your home
B) Determining your risk tolerance for investing in the stock market
C) Determining your credit risk for obtaining a $400 000 mortgage
D) Insuring your home

Answer: D

60) What are the options on whether to or how to protect against risk?
A) Avoid it, reduce it, accept it or share it
B) Homeowner, car, life and health insurance
C) Avoid it, insure it, accept it or share it
D) Eliminate it, avoid it, reduce it, accept it

Answer: A

61) A type of insurance that protects assets is
A) health insurance.
B) disability insurance.
C) self–insurance.
D) home insurance.

Answer: D

62) Which of the following would be the primary objective of investing?
A) Acquiring an estate
B) Earning the highest return possible
C) Earning a return necessary to meet your goals
D) Understanding your risk tolerance

Answer: C

63) Retirement planning should take place
A) shortly before you retire.
B) well before you retire.
C) the day you start your first job.
D) when you retire.

Answer: B

64) One benefit of estate planning is
A) ensuring you have enough money to fund your retirement.
B) sheltering your wealth against all taxes.
C) ensuring that your wealth is distributed according to intestacy laws.
D) protecting your wealth against unnecessary taxes.

Answer: D

65) Which of the following is correct?
A) Liquid savings are not necessary if you have access to adequate credit.
B) Increasing your income will always increase your net worth.
C) Saving part of your income will increase your net worth.
D) Insurance is only relevant when you have a small net worth.

Answer: C

66) Regarding cash flow, which of the following is correct?
A) Selling an investment is a cash outflow.
B) Buying items on sale is a cash outflow.
C) Mortgage payments are a cash inflow.
D) Insurance payments are a cash inflow.

Answer: B

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67) Why is a net worth statement needed?
A) To determine your net cash flow on an annual basis
B) To measure your cash accumulation
C) To measure expenses and develop priorities
D) To measure the value of your assets minus debts

Answer: D

68) Alan has been thinking about his future and is figuring out what his biggest priorities are. At what stage of the planning process is he?
A) Selecting and implementing the best plan
B) Assessing his current financial position
C) Determining financial goals
D) Identifying alternative plans to meet goals

Answer: C

69) If you have total assets of $10 000 and your net worth is $4000, how much liabilities do you have?
A) $10 000
B) $6000
C) $4000
D) $14 000

Answer: B

70) If John's total assets have increased from $10 000 to $15 000 and his liabilities from $5000 to $8000, by how much has John's net worth increased?
A) $2000
B) $4000
C) $5000
D) $3000

Answer: A

71) An investor who earns $65 000 from employment and saves 4.5 percent from his total income would have increased her net worth in one year by
A) $3000.
B) $2900.
C) $0.
D) $2925.

Answer: D

72) The ability of different people to manage their cash flow effectively can be strongly influenced by
A) their socio–economic status.
B) their income level.
C) their need for immediate gratification.
D) the economic environment of the day.

Answer: C

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ESSAY. Write your answer in the space provided or on a separate sheet of paper.

73) Discuss the pros and cons of using consumer credit to supplement liquidity needs.

Answer: Many possibilities.

Cons:
It can lead to personal debt getting out of control.
Some credit, such as credit cards, are a very expensive source of liquidity.
If people are already using credit a lot, then have an actual financial set back, they may not be able to keep up debt payments.
Available credit can be cancelled/reduced by the lender at any time and this may happen right when you need it most.
From 2000 –2018, the level of household debt relative to disposable income increased, the delinquency rate on 90–day non–mortgage debt rose 3.5 percent to 1.12 percent, so there is clearly risk.

Pros:
If used judiciously, credit cards provide a "interest free" loan for a few weeks each month.
Holding funds in an emergency fund that pays no interest (which is the current economic environment) is not an attractive option for an investor.
There are many very low interest sources of credit available to people these days and if only used for emergencies, this can be more cost effective than holding funds in a liquid emergency fund.

74) Explain why an increase in your income may or may not necessarily mean an increase in net worth.

Answer: 1. It does not make any difference what you make, it matters what you do with it.
2. If you get a raise of $1000 per month you could spend it on nicer clothes and entertainment and add nothing to your assets over the year.
3. If you used the $1000 to reduce your debt (e.g., pay down a student loan, or pay off a credit card balance), that would increase your net worth.
4. If you contributed the $1000 each month to your investment account, you would increase your net worth.
5. Most people will spend the money sitting in their bank account, but if you 'pay yourself first', by contributing automatically to a savings or investment account, then your net worth will increase painlessly.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

75) A good example of a personal financial 'SMART' goal would be planning to purchase a home one day.

Answer: True ● False

76) Financial planners are in demand because most people lack understanding or are not interested in making their own financial decisions.

Answer: ● True False

77) If you do not have access to money to cover your cash needs, you may have insufficient liquidity.

Answer: ● True False

78) An example of a 'SMART' goal is: Jack plans to save to buy a car in three years.

Answer: True ● False

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79) Jim's plan to reduce his spending on junk food by $20 per month and save those funds until he has a $2000 emergency fund is an example of a 'SMART' goal.

Answer: True False

80) When goal setting, in order to achieve financial success, goals should be set as aggressively as possible.

Answer: True False

81) If prepared properly, financial plans are set for life and will rarely need to be changed.

Answer: True False

82) Estate planning involves developing a plan to avoid all taxes upon death.

Answer: True False

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

83) How much money to retain in a liquid form and how to allocate funds among short–term investment instruments is called

A) credit management.
B) investment management.
C) money management.
D) liquidity management.

Answer: C

84) Which of the following goals would be 'SMART'?

A) Reduce debt payments.
B) Save 40% of your income for an annual vacation.
C) Invest for a safe and comfortable retirement.
D) Save $100 per month to create a $4000 emergency fund.

Answer: D

85) Planning to pay off a car loan in three years' time is classified as

A) a medium–term goal.
B) investment planning.
C) increasing cash flow.
D) a short–term goal.

Answer: A

86) Which of the following would be classified as a medium–term goal?

A) Retiring in 10 years
B) Saving a down payment to purchase a house in three years
C) Buying new clothes to begin school this month
D) Paying for your two–year–old child's college education

Answer: B

87) Which of the following would defeat the efforts made in developing a successful financial plan?

A) Establishing realistic financial goals
B) Evaluating your financial plan every five years
C) Identifying and evaluating alternative plans that could achieve your goals
D) Considering your current financial position

Answer: B

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88) Which is the most important consideration when establishing your financial goals?
A) Short–term goals should be your only priority.
B) The emergency fund must be established first.
C) The goals should be specific, measurable and realistic.
D) Your goals should be as challenging as possible.

Answer: C

89) Alayne is preparing her budget for the first time. At what stage of the financial planning process is she?
A) Establishing financial goals
B) Budgeting and tax planning
C) Managing her financial resources
D) Considering her current financial situation

Answer: D

90) Nicole has been saving $500 each month for retirement in her Registered Retirement Savings Plan for the past year, but has been carrying a balance on her credit card for four months now. She is concerned about the high interest charges she has been paying on her credit card. At what stage of the financial plan is she?
A) Revising the plan
B) Considering alternate plans
C) Evaluating the plan
D) Establishing financial goals

Answer: A

91) The rate of return on Marika's investments has not been sufficient to meet her retirement goals. What should Marika do regarding her financial plan?
A) Increase her income
B) Delay her retirement a few years
C) Reduce her expenses
D) Revise her plan

Answer: D

92) Alex has become stressed by his tight budget and is unwilling to stick to his financial plan. What action should he take?
A) Revise his plan
B) Implement the best plan
C) Establish his goals
D) Re–evaluate his goals

Answer: A

93) Sharon had a net worth at the beginning of the year of $22 000. At the beginning of the year she received $1000 that she invested and earned 3 percent interest for the year. During the year she also saved $50 each week from her pay cheque in a no–interest chequing account. How much is her net worth at the end of the year?
A) $25 000
B) $23 030
C) $25 600
D) $25 630

Answer: D

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

94) Write out three goals in SMART format.

Answer: There are many possibilities, however, they must be specific, measurable, action oriented, realistic and time bound.

Examples: Save $200 per month for four years in order to have $5000 to purchase a second–hand Honda Fit.

Save $1000 per month from age 30 to 65 in order to be able to retire at age 60 with a similar lifestyle to pre–retirement.

Pay off a student loan of $20 000 over five years by making payments of $400 per month at an interest rate of 7.5 percent.

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95) Name the six steps in the financial planning process and give an example of one activity that would occur at each step.

Answer: Many possibilities but overall cover these topics:

Step 1 Make SMART goals. Establish your financial goals: determine short, medium and long-term goals.

Step 2 Consider current financial position: Cash flow, budget, balance sheet and net worth. Review spending habits and cash flow. Make your personal financial statements and budget.

Step 3 Calculate various alternatives to reach the goals. Identify alternate plans. Review different options that would enable you to reach your various goals successfully

Step 4 Select and implement a plan. Start the required savings, or insurance etc. previously determined. Be prepared to make specific financial decisions based on your discipline and risk tolerance and realistic cash flow.

Step 5 Evaluate your plan: monitor the progress of each component of the plan. Check if the plan is working and you are on track after a few months, and at least once a year.

Step 6 Revise your plan if it is not working out. Or if your circumstances have changed, update your goals and plans appropriately. Review your willingness to follow the plan and adjust it according to your current lifestyle.

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1) TRUE
2) TRUE
3) FALSE
4) TRUE
5) FALSE
6) TRUE
7) FALSE
8) FALSE
9) FALSE
10) FALSE
11) TRUE
12) FALSE
13) FALSE
14) TRUE
15) A
16) A
17) D
18) A
19) B
20) A
21) D
22) D
23) C
24) Possible options:
    1. Financial planner: potential conflict of interest, driven by commissions
    2. Bank adviser: only able to sell in–house product or incompetent advice
    3. Investor education websites: dedicated to improve investor know–how, make sure it is legitimate and get a second opinion before following any online advice
    4. Financial institution websites: watch for conflict of interest, bias, can be useful for certain calculations etc.
    5. Government agency websites: generally safe but limited to general recommendations
    6. Referrals from friends: ask critical questions
25) FALSE
26) FALSE
27) FALSE
28) FALSE
29) FALSE
30) FALSE
31) TRUE
32) FALSE
33) TRUE
34) FALSE
35) FALSE
36) FALSE
37) FALSE
38) A
39) A
40) C
41) C
42) D
43) B

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44) A
45) A
46) B
47) D
48) C
49) A
50) C
51) B
52) C
53) A
54) C
55) B
56) A
57) B
58) C
59) D
60) A
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75) FALSE
76) TRUE
77) TRUE
78) FALSE
79) TRUE
80) FALSE
81) FALSE
82) FALSE
83) C
84) D
85) A
86) B
87) B
88) C
89) D
90) A
91) D
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