CHAPTER 2
MONEY MANAGEMENT SKILLS

CHAPTER OVERVIEW

Successful money management is based on organized financial records, accurate personal financial statements, and effective budgeting. This chapter offers a discussion of the importance and type of financial documents. This is followed by an explanation of the components and procedures for preparing personal financial statements—the balance sheet and the cash flow statement. Next, the chapter covers the basics of developing, implementing, and evaluating a budget. Finally, savings techniques for achieving financial goals are discussed.

LEARNING OBJECTIVES / CHAPTER SUMMARY

After studying this chapter, students will be able to:

Objective	Learning Objective	Chapter Summary
Obj. 1	Identify the main components of wise money management.	Successful money management requires a coordination of personal financial records, personal financial statements, and budgeting activities. An organized system of financial records and documents should provide ease of access as well as security for financial documents that may be impossible to replace.
Obj. 2	Create a personal balance sheet and cash flow statement.	A personal balance sheet, also known as a *net worth statement*, is prepared by listing all items of value (assets) and all amounts owed to others (liabilities). The difference between your total assets and your total liabilities is your net worth. A cash flow statement, also called a *personal income and expenditure statement*, is a summary of cash receipts and payments for a given period, such as a month or a year.
Obj. 3	Develop and implement a personal budget.	The budgeting process involves seven steps: (1) set financial goals; (2) estimate income; (3) budget an emergency funds and savings; (4) budget fixed expenses; (5) budget variable expenses; (6) record spending amounts; and (7) review spending and saving patterns.
Obj. 4	Connect money management activities with saving for personal financial goals.	The relationship among the personal balance sheet, cash flow statement, and budget provides the basis for achieving long-term financial security. Future value and present value calculations may be used to compute the increased value of savings for achieving financial goals

INTRODUCTORY ACTIVITIES

- Ask students to comment on the “3 Steps to Financial Literacy" feature at the start of the chapter (p. 44).
- Point out the learning objectives (p. 45) in an effort to highlight the key points in the chapter.
- Provide an overview of the “Your Personal Financial Plan Sheets” for this chapter (p. 45).
- Ask students to provide examples of problems that could result from not having a definite system for storing personal financial records and documents.
- Point out common methods of budgeting that help a household achieve financial goals and prevent money problems.

CHAPTER 2 OUTLINE

I. A Successful Money Management Plan
    A. Components of Money Management
    B. A System for Personal Financial Records
        1. Money Management Records
        2. Personal and Employment Records
        3. Tax Records
        4. Financial Services Records
        5. Credit Records
        6. Consumer Purchase Records
        7. Housing and Automobile Records
        8. Insurance Records
        9. Investment Records
        10. Estate Planning and Retirement Records
II. Personal Financial Statements
    A. Your Personal Balance Sheet: The Starting Point
        1. Listing Items of Value
        2. Determining Amounts Owed
        3. Computing Net Worth
    B. Your Cash Flow Statement: Inflows and Outflows
        1. Record Income
        2. Record Cash Outflows
        3. Determine Net Cash Flow
III. A Plan for Effective Budgeting
    A. Step 1. Set Financial Goals
    B. Step 2. Estimate Income
    C. Step 3. Budget an Emergency Fund and Savings
    D. Step 4. Budget Fixed Expenses
    E. Step 5. Budget Variable Expenses
    F. Step 6. Record Spending Amounts
    G. Step 7. Review Spending and Saving Patterns
IV. Money Management and Achieving Financial Goals
    A. Selecting a Savings Technique
    B. Calculating Savings Amounts

CHAPTER 2 LECTURE OUTLINE

I. A SUCCESSFUL MONEY MANAGEMENT PLAN (p. 45)

- **Money management** refers to the day-to-day financial activities necessary to handle current personal economic resources while working toward long-term financial security.

Components of Money Management (p. 45)

- Personal financial records, financial statements, and spending plans (budget) are the foundation for planning and implementing money management activities.

A System for Personal Financial Records (p. 46)

- Organized money management requires a system of financial records including the following categories:
  1. money management records
  2. personal and employment records
  3. tax records
  4. financial services records
  5. credit records
  6. consumer purchase records
  7. housing and automobile records
  8. insurance records
  9. investment records
  10. estate planning and retirement records

II. PERSONAL FINANCIAL STATEMENTS (p. 48)

- A personal balance sheet and cash flow statement provide information about a person's or household's current financial position and a summary of current income and spending.

Your Personal Balance Sheet: The Starting Point (p. 48)

- A **balance sheet**, also known as a net worth statement, specifies what you own and what you owe.
- Items of value minus amounts owed equals net worth.
- **Assets**, the first item on the balance sheet, are cash and other property that has a monetary value.

Instructional Suggestions

- **Use PPT slides 2-1 to 2-3**
- **Exercise:** Have students suggest methods that could be used to organize and quickly access personal financial documents and records.
- **Use PPT slide 2-4.**
- **PPT slides 2-5 to 2-13.**
- **Text Highlight:** Exhibit 2-1 (p. 47) provides an overview of a system and suggested locations for storing financial records..
- **Practice Quiz 2-1** (p. 48)
- **Text Reference:** "Apply Yourself" activity (p. 48).
- **Use PPT slide 2-14.**
- **Discussion Question:** How accurate is a balance sheet for measuring the financial progress of an individual or household?
- **Text Highlight:** Exhibit 2-2 (p. 49) explains the process for creating a balance sheet.
- **Use PPT slides 2-15 to 2-19.**

CHAPTER 2 LECTURE OUTLINE

- **Liquid assets** are cash and items of value that can easily be converted into cash.
- **Real estate** includes a home, condominium, vacation property, or other land that a person or family owns.
- Personal possessions are the major portion of assets for most families.
- Investment assets consist of money set aside for long-term financial needs.
- **Liabilities** are amounts owed to others but do not include items not yet due, such as next month's rent.
- **Current liabilities** are debts that must be paid within a short time, usually less than a year.
- **Long-term liabilities** are debts that are not required to be paid in full until more than a year from now.
- Your **net worth** is the difference between your total assets and your total liabilities: Assets **-** Liabilities = Net worth
- The balance sheet of a business is usually expressed as: Assets = Liabilities + Net worth
- **Insolvency** is the inability to pay debts when they are due; it occurs when a person's liabilities far exceed his or her available assets.

"Figure It Out" (p. 51)

- A person or household experiences financial improvement if net worth increases over time.
- **Debt-equity ratio—**liabilities divided by net worth—may be used to indicate a person's financial situation; a low debt ratio is desired.
- **Current ratio**—liquid assets divided by current liabilities—how well a person will be able to pay upcoming debts.
- **Liquidity ratio**—liquid assets divided by monthly expenses—indicates the number of months that expenses can be paid if an emergency arises.
- **Debt-payment ratio**—monthly credit payments divided by take-home pay—provides an indication of how much of a person's earnings goes for debt payments (excluding a home mortgage).
- **Savings ratio**—amount saved each month divided by gross income—financial experts recommend a savings rate of about 10 percent.

Instructional Suggestions

- **Text Reference** Refer students to a summary of financial ratios on page 51. ("Figure It Out" box) (PPT Slide 2-23)

CHAPTER 2 LECTURE OUTLINE

Your Cash Flow Statement: Inflows and Outflows (p. 51)

- **Cash flow** is the actual inflow and outflow of cash during a given time period.
- A **cash flow statement** is a summary of cash receipts and payments for a given period, such as a month or a year.
- **Income** is the inflows of cash to an individual or a household. For most people, the main source of income is money received from a job.
- Cash payments for living expenses and other items make up the second component of a cash flow statement.
- **Fixed expenses** are payments that do not vary from month to month.
- **Variable expenses** are flexible payments that change from month to month.
- The difference between your income and your cash outflows can be either a positive (**surplus**) or negative (**deficit**) cash flow. A deficit exists if more cash goes out than comes in during a month. This amount must be made up by withdrawals from savings or borrowing.

III. A PLAN FOR EFFECTIVE BUDGETING (p. 54)

- A budget, or *spending plan*, is necessary for successful financial planning. The main purposes of a budget are to help you
  1. live within your income
  2. spend your money wisely
  3. reach your financial goals
  4. prepare for financial emergencies
  5. develop wise financial management habits
- Budgeting may be viewed in seven main steps:
  1. Set financial goals
  2. Estimate income
  3. Budget an emergency funds and savings
  4. Budget fixed expenses
  5. Budget variable expenses
  6. Record spending amounts
  7. Review spending and saving patterns

Instructional Suggestions

- **Text Highlight:** Exhibit 2-3 (p. 52) provides an overview of the process for creating a cash flow statement.
- **PPT slides 2-20 to 2-22.**
- **Discussion Question:** What information does a cash flow statement provide that is not available on a personal balance sheet?
- **Exercise:** Have students list the various sources of income (cash inflows available for spending) of people in our society.
- **Discussion Question:** What relationship exists between the balance sheet and cash flow statement?
- **Practice Quiz 2-2** (pp. 54)
- **Text Reference:** "Apply Yourself" activity (p. 54).
- **Use PPT slides 2-24 to 2-31.**
- **Discussion Question:** Is every individual and household forced to budget, with some more organized and planned than others?
- **Exercise**: Have students suggest common financial goals.

CHAPTER 2 LECTURE OUTLINE

- Your **lifestyle** is how you spend your time and money and is strongly influenced by your career, family, and personal values.

Step 1. Set Financial Goals (p. 54)

- Financial goals are plans for future activities that require you to plan spending, savings, and investing.
- How much you budget for various items will depend on current needs and plans for the future. Sources that can assist with planning your spending include:
  - your cash flow statement
  - sample budgets from government reports
  - articles in personal financial planning magazines
  - estimates of future income and expected inflation

Step 2. Estimate Income (p. 55)

- Available money should be estimated for a given time period—such as a month.
- Income variations (due to seasonal work or sales commissions) should be based on the recent past and realistic expectations.

Step 3. Budget an Emergency Fund and Savings (p. 55)

- An emergency fund and savings for irregular payments should be first set aside to avoid not having anything left for savings.

Instructional Suggestions

- **Text Highlight:** Exhibit 2-6 (page 57) provides suggested budget allocations for different life situations.
- **Exercise:** Have students allocate budget categories (using percentages) for different household situations.

CHAPTER 2 LECTURE OUTLINE

Step 4. Budget Fixed Expenses (p. 55)

- Definite obligations (rent, mortgage, and credit payments) should be allocated first.
- Assigning amounts to spending categories can be based on your cash flow statement, government data, current magazine articles, and estimates of future income and expenses.
- A "spending diary" of past expenses can also assist with this task.

Step 5. Budget Variable Expenses (p. 57)

- Planning for variable expenses is more difficult than fixed expenses.
- These expenses will fluctuate based on household situation, time of the year, health, economic conditions, and other factors.

Step 6. Record Spending Amounts (p. 57)

- A **budget variance** is the difference between amount budgeted and the actual amount received or spent. A **deficit** exists when actual spending exceeds planned spending. A **surplus** is when actual spending is less than planned spending.

Step 7. Review Spending and Saving Patterns (p. 58)

- The results of your budget may be obvious—having extra cash, falling behind in payments. Or the results may need to be reviewed in detail to determine areas of needed changes. The most common overspending areas are entertainment and food, especially away-from-home meals.
- At this point of the budgeting process, you should also evaluate, reassess, and revise your financial goals.

Successful Budgeting (p. 59)

- A successful budget should be:
  - ∗ well-planned
  - ∗ realistic
  - ∗ flexible
  - ∗ clearly communicated

Selecting a Budgeting System (p. 59)

- Commonly used budgeting systems are: mental, physical, written, and computerized.

Instructional Suggestions

- **Text Reference:** The "Personal Finance in Practice" box (p. 58) suggests guidelines for a SWOT analysis for money management activities and budgeting.
- **Question:** What factors can contribute to unsuccessful budgeting? How can these situations be avoided?
- **Practice Quiz 2-3** (p. 60)
- **Text Reference:** "Apply Yourself" activity (p. 60)

CHAPTER 2 LECTURE OUTLINE

V. MONEY MANAGEMENT AND ACHIEVING FINANCIAL GOALS (p. 60)

- Personal financial statements and a budget help achieve financial goals with
  1. the balance sheet reporting current financial position—*where you are now*.
  2. the cash flow statement: telling what was *received and spent over the past month*.
  3. a budget for *planning spending and saving to achieve financial goals*.
- People commonly prepare a balance sheet on a periodic basis, such as every three or six months. Between those points in time, a budget and cash flow statement help plan and measure spending and saving activities.

Selecting a Savings Technique (p. 62)

- Since most people find saving difficult, financial advisers suggest several methods:
  - ∗ write a check each payday and deposit it in a distant financial institution
  - ∗ use payroll deduction, direct deposit
  - ∗ save coins
  - ∗ spend less on certain items

Calculating Savings Amounts (p. 62)

- To achieve financial objectives, you should convert your savings goals into specific amounts.
- Your use of an interest-earning savings plan is vital to the growth of your money and the achievement of your financial goals.

Instructional Suggestions

- **Use PPT slides 2-32 to 2-40.**
- **Additional Example:** People unable to save regularly are usually:
  - ∗ individuals without specific savings goals
  - ∗ people who always seem to use up savings for unexpected expenses
  - ∗ those who overuse credit
  - ∗ people who buy to have the same things as others
  - ∗ individuals who lack common financial goals with other family members
- **Text Highlight:** “From the Pages of *Kiplinger’s Personal Finance*” (p. 61).
- **Practice Quiz 2-4** (p. 63)
- **Text Reference:** “Apply Yourself” activity (p. 63).

CONCLUDING ACTIVITIES

- Discuss "Your Personal Finance Dashboard" and possible financial planning actions (p. 63).
- Point out the chapter summary (p. 64) and key terms in the text margin.
- Assign and discuss selected end-of-chapter Problems, Questions, Case in Point, and Continuing Case.
- Encourage students to maintain a "Daily Spending Diary" (p. 69 and Appendix D)
- Discuss "Your Personal Financial Plan" worksheets.
- Use the Chapter Quiz in the *Instructor's Manual*.

YOUR PERSONAL FINANCIAL PLAN WORKSHEETS FOR USE WITH CHAPTER 2

Sheet 5	Financial Documents and Records
Sheet 6	Creating a Personal Balance Sheet
Sheet 7	Creating a Personal Cash Flow Statement
Sheet 9	Developing a Personal Budget

CHAPTER 2 QUIZ ANSWERS

True-False	*Multiple Choice*
1. F (p. 46)	6. A (p. 54)
2. T (p. 48)	7. C (p. 49)
3. F (p. 50)	8. D (p. 50)
4. T (p. 51)	9. B (p. 52)
5. T (p. 57)	10. B (p. 55)

Name ____ Date ____________________________

CHAPTER 2 QUIZ

TRUE-FALSE

_____1. Most financial records should be kept in a safe-deposit box.

_____2. A personal balance sheet reports the financial position of a person or family on a given date.

_____3. Assets represent amounts owed to others that must be paid within the next year.

_____4. Spending less than your income will increase net worth.

_____5. A budget deficit exists when actual spending exceeds projected spending.

MULTIPLE CHOICE

_____6. A(n) __________ is a specific plan for spending.
a. budget
b. balance sheet
c. income statement
d. bank statement

_____7. An example of a liquid asset would be
a. a home.
b. an automobile.
c. a checking account.
d. retirement account.

_____8. __________ represents amounts owed to others.
a. Current assets
b. Expenses
c. Mutual funds
d. Liabilities

_____9. A personal cash flow statement presents
a. amounts earned from savings.
b. income and payments.
c. assets and liabilities.
d. amounts owed to others.

_____10. Definite financial obligations are referred to as
a. variable expenses.
b. fixed expenses.
c. equity.
d. investment assets.

SUPPLEMENTARY LECTURE

Financial Ratios to Measure and Evaluate Financial Progress

Type	Calculations	Example
A. Debt-equity ratio	liabilities divided by net worth	$50,000/$40,000 = 1.25

Interpretation: These items express the relationship between your debts and personal net worth. A lower debt ratio is desired.

B. Current ratio	liquid assets divided by current liabilities	$7,000/$4,000 = 1.75

Interpretation: Indicates how well you will be able to pay upcoming debts. A higher number is more desirable.

C. Liquidity ratio	liquid assets divided by monthly expenses	$7,000/$2,800 = 2.5

Interpretation: Indicates the number of months a person will be able to pay expenses if an emergency situation arises. Again, a higher number is desired especially if uncertainty exists regarding continual employment.

D. Solvency ratio	total assets divided by total liabilities	$98,000/$67,000 = 1.46

Interpretation: Shows the relationship between the value of assets and what is owed. A higher number is desired.

E. Debt Payments ratio	monthly credit payments divided by monthly take	$450/$2,500 = 0.18

Interpretation: Expresses portion of monthly earnings going for credit payments. A lower ratio is desired.

F. Savings ratio	additions to savings plans divided by take-home pay	$2,080/$32,800 = 0.065

Interpretation: Presents the portion of annual earnings that has been saved.

G. Investment assets ratio	investment assets divided by net worth	$77,000/$101,000 = 0.76

Interpretation: Indicates portion of net worth that contributes to long-term financial goals.

Supplementary Lecture: Money Management Troubles and Debt

Difficult economic conditions often create difficult personal financial situations, often in the form of increased debt.

The process of getting out of debt may include actions to:

- Evaluate your credit situation
- Track your spending
- Plan to make payments on time
- Consider other income sources
- If appropriate, seek assistance

ANSWERS TO PRACTICE QUIZZES, PROBLEMS, QUESTIONS, AND CASES

PRACTICE QUIZZES

Practice Quiz 2-1 (p. 48)

1. What are the three major money management activities?

   The three major money management activities are (1) storing and maintaining financial records and documents, (2) creating personal financial statements, and (3) creating and implementing a budget. (p. 45)

2. What are the benefits of an organized system of financial records and documents?

   An organized system of financial records provides a basis for: (1) handling daily business activities, such as bill paying; (2) planning and measuring financial progress; (3) completing required tax reports; (4) making effective investment decisions; and (5) determining available resources for current and future spending. (pp. 46)

3. For each of the following records, check the column to indicate the length of time the item should be kept. "Short-time period" refers to less than five years.

Document	**Short time period**	**Longer-time period**
Credit card statements	X	
Mortgage documents		X
Receipts for furniture, clothing	X	
Retirement account information		X
Will		X

Practice Quiz 2-2 (p. 54)

1. What are the main purposes of personal financial statements?

   (1) Report your current financial position in relation to the value of the items you own and the amounts you owe; (2) measure your progress toward your financial goals; (3) maintain information on your financial activities; (4) provide data that you can use when preparing tax forms or applying for credit. (p. 48)

2. What does a personal balance sheet tell you about your financial situation?

   A balance sheet consists of assets (items of value), liabilities (amounts owed to others), and net worth (the difference between the total assets and total liabilities.) (pp. 48-50)

3. For the following items, identify each as an asset (A), liability (L), cash inflow (CI), or cash outflow (CO):

CO	monthly rent	L	automobile loan
CI	interest on savings account	A	collection of rare coins
A	retirement account	L	mortgage amount
CO	electric bill	A	market value of automobile

4. Jan Franks has liquid assets of $6,300 and monthly expenses of $2,100. Based on the liquidity ratio, she has 3 months in which living expenses could be paid if an emergency arises.

Practice Quiz 2-3 (p. 60)

1. What are the main purposes of a budget?

   The main purposes of a budget are to help you: (1) live within your income; (2) spend your money wisely; (3) reach your financial goals; (4) prepare for financial emergencies; and (5) develop wise financial management habits. (p. 54)

2. How does a person's life situation affect goal setting and amounts allocated for various budget categories?

   Different life situations will affect household goals and plans for spending based on needs and desires of those involved. Delayed marriage might mean more spending for travel and leisure; deferred parenthood might be due to plans for advanced career training and returning to school; divorce will affect housing size needs and could mean child care expenses.

3. For each of the following household expenses, indicate if the item is FIXED expense or a VARIABLE expense.

VARIABLE	food away from home	FIXED	cable television
FIXED	Rent	VARIABLE	electricity
FIXED	health insurance premium	VARIABLE	auto repairs

4. The Nollin family has budgeted expenses for a month of $4,560 and actual spending of $4,480.

   This would result in a budget SURPLUS or DEFICIT (circle one) of $ 80

Practice Quiz 2-4 (p. 63)

1. What relationship exists among personal financial statements, budgeting, and achieving financial goals?

   The balance sheet and cash flow statement provide information about a person's current financial situation. These allow a person to plan his or her budget to set spending and saving plans that relate to achieving financial goals.

2. What are some suggested methods to make saving easy?

   Suggested savings methods include "pay yourself first," payroll deduction, saving coins, and eliminating spending on a certain item. (p. 62)

3. If a person desires to obtain the following information, check the box for the document that would be most useful.

Financial information needed	Balance sheet	Cash flow statement	Budget
Amounts owed for medical expenses	X		
Spending patterns for the past few months		X	
Planned spending patterns for the next month			X
Current value of investment accounts	X		
Amounts to deposit in savings accounts			X

DISCUSSION QUESTIONS (p. 65)

1. Describe some common money management mistakes that can cause long-term financial concerns?

Spending more than their income is the main mistake people make. In addition, the overuse of credit, impulse buying, and not monitoring spending are other concerns.

2. What do you believe to be the major characteristics of an effective system to keep track of financial documents and records?

Students should be encouraged to point out that a system should be relatively simple, should allow quite access to items, and should be updated regularly.

3. How might financial ratios be used when planning and implementing financial activities?

These ratios can be an indication of financial progress. Some should be high (such as savings ratio), while others should be low (debt-equity ratio).

4. Discuss with several people how a budget might be changed if a household faced a decline in income. What spending areas might be reduced first?

This activity can help students better understand problems associated with money management and cash flow. In addition, students can obtain practical advice on coping with this situation. Opinions on this item will vary. Students should be ready to accept different points of views that reflect a person’s life situation, goals, and personal values.

5. What are long-term effects of low savings for both individuals and the economy of a country?

Low savings for individuals will result in not having funds available for emergencies and poor long-term financial security. For the economy, a low savings/investment rate will limit the funds available for use by companies to expand and create jobs.

PROBLEMS (p. 65)

1. Based on the following data, determine the amount of total assets, total liabilities, and net worth. (LO 2.2)

Liquid assets, $3,870	Investment assets, $8,340
Current liabilities, $2,670	Household assets, $87,890
Long-term liabilities, $76,230	

a. Total assets $________________

b. Total liabilities $______________

c. Net worth $__________________

Total assets = $100,100 ($3,870 + 8,340 + 87,890)
Total liabilities = $78,900 ($2,670 + $76,230)
Net worth = $21,200 ($100,100 - $78,900)

2. Using the following balance sheet items and amounts, calculate the total liquid assets and total current liabilities: (LO 2.2)

Money market account $2,600	Medical bills $262
Mortgage $158,000	Checking account $780
Retirement account $87,400	Credit card balance $489

a. Total liquid assets $___________________

b. Total current liabilities $_________________

a. Total liquid assets $\boxed{\$3,380}$

b, Total current liabilities $\boxed{\$751}$

3. Use the following items to determine the total assets, total liabilities, net worth, total cash inflows, and total cash outflows. (LO 2.2)

Rent for the month, $650	Monthly take-home salary, $2,185
Spending for food, $345	Cash in checking account, $450
Savings account balance, $1,890	Balance of educational loan, $2,160
Current value of automobile, $8,800	Telephone bill paid for month, $65
Credit card balance, $235	Loan payment, $80
Auto insurance, $230	Household possessions, $3,400
Video equipment, $2,350	Payment for electricity, $90
Lunches/parking at work, $180	Donations, $160
Personal computer, $1,200	Value of stock investment, $860
Clothing purchase, $110	Restaurant spending, $130

a. Total assets $____________________

b. Total liabilities $____________________

c. Net worth $____________________

d. Total cash inflows $____________________

e. Total cash outflows $____________________

Total assets = $18,950 ($450 + 1,890 + 8,800 + 2,350 + 1,200 + 3,400 + 860)
Total liabilities = $2,395 ($235 + $2,160)
Net worth = $16,555 ($18,950 - $2,395)
Total cash inflows = $2,235
Total cash outflows = $2,040 ($650 + 345 + 230 + 180 + 110 + 65 + 80 + 90 + 160 + 130)

4. For each of the following situations, compute the missing amount. (LO 2.2)

a. Assets $65,000; liabilities $18,000; net worth $47,000

b. Assets $86,500; liabilities $67,800 ; net worth $18,700

c. Assets $34,280; liabilities $12,965; net worth $21,315

d. Assets $90,999; liabilities $38,345; net worth $52,654

5. Based on this financial data, calculate the ratios requested: (LO 2.2)

Liabilities, $7,800	Net worth, $58,000
Liquid assets, $4,600	Current liabilities, $1,300
Monthly credit payments, $640	Take-home pay, $2,575
Monthly savings, $130	Gross income, $2,850

a. Debt ratio ____________________ *b.* Current ratio ____________________

c. Debt-payments ratio ________________ *d.* Savings ratio ____________________

a. Debt ratio 7,800/58,000 = 0.134 b. Current ratio 4,600/1,300 = 3.54

c. Debt-payments ratio 640/2,575 = 0.2485 d. Savings ratio 130/2,850 = 0.046

6. The Fram family has liabilities of $128,000 and a net worth of $340,000. What is the debt ratio? How would you assess this? (LO 2.2)

$128,000 / $340,000 = .376 represents a ratio of less than 40 percent, which would need to be assessed in relation to previous trends and the ratio of comparable households.

7. Carl Lester has liquid assets of $2,680 and current liabilities of $2,436. What is his current ratio? What comments do you have about this financial position? (LO 2.2)

$2,680 / $2,436 = 1.1, which could be viewed as lower than would be desirable.

8. For the following situations, calculate the cash surplus or deficit: (LO 2.2)

Cash Inflows	Cash Outflows	Difference (surplus or deficit)	
$3,460	$3,306 ___	x $242	surplus
$4,693	$4,803 __	x $47	deficit
$4,287	$4,218	$69	surplus

9. The Brandon household has a monthly income of $5,630 on which to base their budget. They plan to save 10 percent and spend 32 percent on fixed expenses and 56 percent on variable expenses. (LO 2.3)

a. What amount do they plan to set aside for each major budget section?

Savings $__________

Fixed expenses $__________

Variable expenses $__________

Savings	$ 563
Fixed Expenses	$1,801.60
Variable Expenses	$3,152.80

b. After setting aside these amounts, what amount would remain for additional savings or for paying off debts?

$112.60

10. Fran Powers created the following budget and reported the actual spending listed. Calculate the variance for each of these categories, and indicate whether it was a *deficit* or a *surplus.* (LO 2.3)

Item	Budgeted	Actual	Variance	Deficit/Surplus
Food	$360	$298	_______	_______
Transportation	320	334	_______	_______
Housing	950	982	_______	_______
Clothing	110	134	_______	_______
Personal	275	231	_______	_______

Food \$62 surplus; transportation \$14 deficit; housing \$32 deficit; clothing \$24 deficit; personal expenses \$44 surplus.

11. Ed Weston recently lost his job. Before unemployment occurred, the Weston household (Ed; wife, Alice; two children, ages 12 and 9) had a monthly take-home income of \$3,165. Each month, the money went for the following items: \$880 for rent, \$180 for utilities, \$560 for food, \$480 for automobile expenses, \$300 for clothing, \$280 for insurance, \$250 for savings, and \$235 for personal and other items. After the loss of Ed's job, the household's monthly income is \$1,550, from his wife's wages and his unemployment benefits. The Westons also have savings accounts, investments, and retirement funds of \$28,000. (LO 2.3)

a. What budget items might the Westons consider reducing to cope with their financial difficulties?

Common cutbacks occur in the areas of food, clothing, savings, and personal spending.

b. How should the Westons use their savings and retirement funds during this financial crisis? What additional sources of funds might be available to them during this period of unemployment?

Savings funds should be used to pay fixed expenses and necessities. Retirement funds should only be used if a lengthy unemployment time is encountered or if large, expected expenses occur. Other sources of funds may include loans, sale of investments, or sale of no longer needed household items.

12. Use future value and present value calculations (see tables in the appendix for Chapter 1) to determine the following: (LO 2.4)

a. The future value of a \$600 savings deposit after eight years at an annual interest rate of 6 percent.

$\$600 \times 1.594 = \$956.40$

b. The future value of saving \$1,800 a year for five years at an annual interest rate of 5 percent.

$\$1,800 \times 5.526 = \$ 9,946.80$

c. The present value of a \$2,000 savings account that will earn 3 percent interest for four years.

$\$2,000 \times 0.885 = \$1,770$

13. Brenda plans to reduce her spending by \$50 a month. What would be the future value of this reduced saving over the next 10 years? (Assume an annual deposit to her savings account, and an annual interest rate of 3 percent.) (LO 2.4)

\$50 X 12 = \$600 X 11.464 (future value of annuity) = \$6,878.40

14. Kara George received a $5,000 gift for graduation for her uncle. If she deposits this in a account paying 3 percent, what will be the value of this gift in 12 years? (LO 2.4)

$5,000 X 1.426 = $7,130

CASE IN POINT (p. 67)

Adjusting the Budget

1. What situations might have created the budget deficit for the Constantine family?

Possible answers include: a lack of planning, not monitoring spending actions, not setting financial goals, and unexpected expenses due to an emergency or other circumstances.

2. What amounts would you suggest for the various categories for the family budget?

While student answers will vary, some suggested actions might include reduced spending in certain areas (food away from home, cable and internet, and more careful spending for groceries) along with a revised budget and perhaps actions to increased household income.

3. Describe additional actions for the Constantine family related to their budget or other money management activities.

Possible answers might include: involve all family members in the budgeting process, assessing current and future insurance needs, setting financial goals and regular savings to achieve those goals.

CONTINUING CASE (p. 68)

1. According to the text, a personal balance sheet is a statement of your net worth. It is an accounting of what you own as well as what you owe.

Using the information provided, prepare a personal balance sheet for Jamie Lee.

Solution:
The formula for a personal balance sheet (as seen on page 49) is as follows:

Items of Value (*what you own*) **- Amounts owed** (*what you owe*) = **Your net worth** (*your wealth*)

ASSETS (WHAT YOU OWN)	MINUS	LIABILITIES (WHAT YOU OWE)	= NET WORTH (YOUR WEALTH)
CHECKING ACCOUNT: $1,250		**STUDENT LOAN: $5,400**	
EMERGENCY FUND SAVINGS ACCOUNT: $3,100		**CREDIT CARD BALANCE: $400**	
CAR: $4,000			
$8,350	**-**	**$5,800**	**= $2,550**

Jamie Lee has a positive net worth of $2,550.

2. Using the table found in *Ratios for Evaluating Financial Progress* on page 51, what is Jamie Lee's debt ratio?

When comparing Jamie Lee's liabilities and her net worth, is the relationship a favorable one?

Solution:

The formula for calculating her debt ratio is as follows:

Liabilities/Net Worth = Debt Ratio
$5,800 / $2,550 = 2.27

Jamie Lee's debt ratio is 2.27.
No, it is not a favorable relationship; her liabilities are over twice as much as her net worth.

3. Using the table found in *Ratios for Evaluating Financial Progress* on page 51, what is Jamie Lee's savings ratio?

Using the rule of thumb recommended by financial experts, is she saving enough?

Solution:

The formula for calculating her savings ratio is as follows:

Amount Saved Each Month/ Gross Income = Savings Ratio
$175/ $2,125 = 0.08

Jamie Lee's savings ratio is .08 or 8%.
The amount to deposit in to savings per month, as recommended by financial experts, is between 5% and 10% of the gross income amount.
Jamie is saving 8% of her gross income amount, so she is in an optimal range.

4. Using Exhibit 2-6: *Typical After-Tax Budget Allocations for Different Life Situations* found on page 57, calculate the budget allocations for Jamie Lee, using her Net Monthly Salary (or After-tax Salary) amount.

Is she within the recommended parameters for a student?

BUDGET CATEGORY	RECOMMENDATION % FOR STUDENT	JAMIE LEE'S AMOUNT	WITHIN RECOMMENDED PARAMETERS?
HOUSING (RENT, UTILITIES)	0-25%	($275+$175)/$1,560 = 25%	YES
TRANSPORTATION	5-10%	$100/$1,560 = 6%	YES
ENTERTAINMENT AND RECREATION	5-10%	$85/$1,560 = 5%	YES
SAVINGS	0-10%	$175/$1,560 = 11%	NO

Jamie Lee is within all the recommended parameter set for a student life situation in the budget categories of housing, transportation, entertainment, and savings. Her savings is slightly over the recommendation of 10%, with her ratio calculating at 11%.

Note: These calculations use after tax (Net Monthly Salary) amounts versus other ratios shown in the text that utilize gross monthly amounts.

DAILY SPENDING DAIRY (p. 69)

This activity will help students better plan their spending for both short-term and long-term financial decisions.