

## Ch. 2 - Measuring Your Financial Health and Making a Plan

### Problems and Activities (pg. 55) #5:

"Faith Brooks, a 28-year-old college graduate, never took a personal finance class. She pays her bills on time, has managed to save a little in a mutual fund, and with the help of an inheritance managed a down payment on a condominium. But Faith worries about her financial situation. Given the following information, prepare an income statement, balance sheet, and calculate the current ratio, savings ratio, monthly living expenses covered ratio, debt ratio, and long-term debt coverage ratio. Interpret these financial statements and ratios for Faith. Based on your assessment, what advice would you give Faith? In addition to the following list, Faith offers these explanations:

- All short-term and long-term liabilities are unpaid
- Other expenses, monthly represents cash spent without record
- She charges all incidentals on her credit cards and pays the balances off monthly. The balances given represent her average monthly balances.

Visa bill	\$355	
Stocks	\$5,500	
MasterCard bill	\$245	
Monthly paycheck, net	\$2,400	
Annual medical expenses	\$264	
Mortgage payment, monthly	\$530	
Temple Mutual Fund	\$2,100	
401(k) retirement account	\$4,500	
Car payment, monthly	\$265	
Total monthly utilities	\$275	
Savings account	\$2,300	
Clothing expense, monthly	\$45	
Quarterly auto insurance (not due)	\$450	
Inherited coin collection	\$3,250	
Condominium	\$65,000	
Food, monthly	\$225	
Auto	\$9,000	
Furnishings	\$5,500	
Mortgage outstanding	\$50,000	
Auto loan outstanding	\$4,225	
Other personal property	\$8,000	
Other expenses, monthly	\$150	."

### **Balance Sheet**

#### Assets

Stocks	\$5,500
Temple Mutual Fund	\$2,100
401(k) retirement account	\$4,500
Savings account	\$2,300
Inherited coin collection	\$3,250
Condominium	\$65,000
Auto	\$9,000

Furnishings	\$5,500
<u>Other personal property</u>	<u>\$8,000</u>
<b>Total Assets:</b>	<b>\$105,150</b>

Liabilities

Mortgage outstanding	\$50,000
<u>Auto loan outstanding</u>	<u>\$4,225</u>
<b>Total Liabilities</b>	<b>\$54,225</b>

<u>Net Worth</u>	<u>\$50,925</u>
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**Income Statement**

Income

Monthly paycheck, net	\$2,400
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Expenses

Visa bill	\$355	
MasterCard bill	\$245	
Monthly medical expenses	\$22	(\$264 / 12)
Mortgage payment, monthly	\$530	
Car payment, monthly	\$265	
Total monthly utilities	\$275	
Clothing expense, monthly	\$45	
Monthly auto insurance (not due)	\$150	(\$450 / 3)
Food, monthly	\$225	
<u>Other expenses, monthly</u>	<u>\$150</u>	
<b>Total Expenses</b>	<b>\$2,262</b>	

<u>Net Income</u>	<u>\$138</u>
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**current ratio = monetary assets / current liabilities**

$$\underline{\hspace{2cm}} = \underline{\hspace{2cm}} / \underline{\hspace{2cm}}$$

[Current ratio should be higher than 1.0, but financial advisors look for it to be higher than 2.0]

**month's living expenses covered ratio = monetary assets / (annual living expenses / 12)**

$$\underline{\hspace{2cm}} = \underline{\hspace{2cm}} / (\underline{\hspace{2cm}} / 12)$$

[Enough cash and liquid assets available to pay \_\_\_\_\_ months worth of expenses]

**debt ratio = total debt or liabilities / total assets**

$$\underline{\hspace{2cm}} = \underline{\hspace{2cm}} / \underline{\hspace{2cm}}$$

[Answer would indicate % of assets have been purchased through borrowing]

**long-term debt coverage ratio = total income available for living expenses / total long-term debt payments**

$$\underline{\hspace{2cm}} = \underline{\hspace{2cm}} / \underline{\hspace{2cm}}$$

[Anything below 2.5 should raise a caution flag]

