

Ch 01: Understanding the Financial Process

True / False

1. The average propensity to consume is commonly viewed as a key determinant of standard of living.

- a. True
- b. False

ANSWER: False

2. Financial planning can improve your standard of living.

- a. True
- b. False

ANSWER: True

3. Standard of living is defined as the necessities, comforts, and luxuries desired by an individual or a family.

- a. True
- b. False

ANSWER: True

4. The support of philanthropic organizations is a material item that contributes to our quality of life.

- a. True
- b. False

ANSWER: False

5. The most effective way to achieve financial objectives is through personal financial planning.

- a. True
- b. False

ANSWER: True

6. Two people with significantly different incomes can have equal average propensities to consume because of differences in their standard of living.

- a. True
- b. False

ANSWER: True

7. Morgan has an annual income of \$45,000 and spends \$30,000 for current needs. Morgan's average propensity to consume is 80 percent.

- a. True
- b. False

ANSWER: False

8. Tangible (physical) assets are earning assets that are held for the returns they promise.

- a. True
- b. False

ANSWER: False

9. It is easy to change your partner's financial style, so there is no need for financial planning to resolve conflicts

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regarding money matters.

- a. True
- b. False

ANSWER: False

10. The need for financial planning declines as your income increases.

- a. True
- b. False

ANSWER: False

11. When you get your first job, you should make a good financial plan that you can follow without making changes until you retire.

- a. True
- b. False

ANSWER: False

12. Saving \$400 for a large, flat-screen TV within the next four months is an example of a short-term goal.

- a. True
- b. False

ANSWER: True

13. Short-term planning should include creating and maintaining an emergency fund with at least six months' worth of income.

- a. True
- b. False

ANSWER: True

14. You should discuss your financial goals and attitudes toward money with your partner.

- a. True
- b. False

ANSWER: True

15. For employees of large firms, managing employee benefits is an important part of financial planning.

- a. True
- b. False

ANSWER: True

16. Accumulating wealth for later years is called estate planning.

- a. True
- b. False

ANSWER: False

17. The longer you wait to begin retirement planning, the less you are likely to have in your retirement fund.

- a. True

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b. False

ANSWER: True

18. Tax plans are closely tied to investment plans.

a. True

b. False

ANSWER: True

19. Most people tend to be more liberal about their expenditures during a recession or crisis.

a. True

b. False

ANSWER: False

20. You should limit your spending to no more than 20 percent more than what you earn.

a. True

b. False

ANSWER: False

21. Commission-based financial planners charge fees based on the complexity of the plan they prepare.

a. True

b. False

ANSWER: False

22. Fee-only financial planners earn commissions for the products they sell.

a. True

b. False

ANSWER: False

23. Retirement planning includes taking advantage of and managing employer-sponsored benefits.

a. True

b. False

ANSWER: True

24. Recessions and financial crises will always result in job loss.

a. True

b. False

ANSWER: False

25. Financial planning takes place in a dynamic economic environment created by the actions of the government, business, and consumers.

a. True

b. False

ANSWER: True

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26. Your purchase, saving, investment, and retirement plans and decisions are not influenced by the present state of the economy.

- a. True
- b. False

ANSWER: False

27. The federal government delegates its regulation of economic activity function to businesses and consumers.

- a. True
- b. False

ANSWER: False

28. Living costs are constant throughout the country.

- a. True
- b. False

ANSWER: False

29. Geographic factors affect your earning power.

- a. True
- b. False

ANSWER: True

30. Marital status affects the income level of individuals.

- a. True
- b. False

ANSWER: True

31. In the United States, salaries tend to be higher in the Northeast and West than in the South.

- a. True
- b. False

ANSWER: True

32. The decisions you make in career planning are independent of the decisions you make in financial planning.

- a. True
- b. False

ANSWER: False

33. Setting long- and short-term career goals helps in career planning.

- a. True
- b. False

ANSWER: True

34. Career plans should not be changed after long- and short-term career goals are set.

- a. True
- b. False

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ANSWER:

False

Multiple Choice

35. Personal financial planning is important because it:

- a. controls inflation.
- b. limits consumption.
- c. reduces social disparity.
- d. results in an improved standard of living.
- e. reduces economic differences among individuals.

ANSWER:

d

36. Financial planning helps us:

- a. control inflation.
- b. have flexibility to handle job loss.
- c. control unemployment rates.
- d. obtain a Social Security number.
- e. decrease national debt.

ANSWER:

b

37. The best way to achieve your financial objectives is to:

- a. have a luxurious standard of living.
- b. spend your money at once to reach your objectives swiftly.
- c. develop a sound financial plan.
- d. create a good tax deferment strategy.
- e. monitor your spending.

ANSWER:

c

38. An individual's quality of life is closely tied to their:

- a. political orientation.
- b. charitable contributions.
- c. pollution control efforts.
- d. standard of living.
- e. educational qualifications.

ANSWER:

d

39. A key determinant of an individual's quality of life is their:

- a. tax bill.
- b. financial goals.
- c. wealth.
- d. motivation.
- e. growth potential.

ANSWER:

c

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40. What type of plans are most helpful in making decisions regarding retirement?

- a. Personal financial
- b. Insurance
- c. Estate
- d. Business
- e. Spending

ANSWER:

a

41. The average propensity to consume refers to:

- a. the dollars of income spent on luxury goods.
- b. the dollars of income saved by an individual.
- c. expenditures on the basic necessities of life.
- d. the percentage of income spent for current needs.
- e. the fact that people with higher propensity to consume earn lower income.

ANSWER:

d

42. Neha graduated with a master's degree in personal financial planning. After working for two years in a small financial planning firm, Neha earns \$85,000 annually and saves \$5,000 a year after spending on current needs. What is Neha's average propensity to consume?

- a. 5 percent
- b. 25 percent
- c. 60 percent
- d. 88 percent
- e. 94 percent

ANSWER:

e

43. Which of the following is a reason for a decrease in the average propensity to consume with an increase in income?

- a. The amount of savings decreases, and the consumption of necessities increases.
- b. The expenditure on luxury goods increases, and the amount of savings decreases.
- c. The expenditure on luxury goods represents only a small portion of income.
- d. The amount of savings represents only a small portion of income.
- e. The cost of necessities represents only a small portion of income.

ANSWER:

e

44. What is the term for the net total value of all the items that an individual owns?

- a. Wealth
- b. Propensity to consume
- c. The consumer price index (CPI)
- d. Purchasing power
- e. Credit debt

ANSWER:

a

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45. Stocks, bonds, and mutual funds are considered what type of assets?

- a. Physical
- b. Earning
- c. Fixed
- d. Tangible
- e. Real

ANSWER:

b

46. The purchase of a car is an example of:

- a. consuming.
- b. investing.
- c. saving.
- d. deferring.
- e. distributing.

ANSWER:

a

47. An example of the purchase of a financial asset would be the purchase of:

- a. a painting.
- b. stocks.
- c. a car.
- d. jewelry.
- e. a vacation home.

ANSWER:

b

48. A trend with a profound effect on people's standard of living and that requires greater responsibility to manage money wisely is the:

- a. single-income family.
- b. two-income family.
- c. investment family.
- d. retirement-income family.
- e. government.

ANSWER:

b

49. A carefully developed financial plan should allow for deferred future spending by setting aside a portion of:

- a. retirement funds.
- b. investment funds.
- c. current income.
- d. future income.
- e. tangible assets.

ANSWER:

c

50. Which of the following represents a systematic process that considers important elements of an individual's financial affairs in order to fulfill financial goals?

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- a. Conflict resolution
- b. Personal financial planning
- c. Standard of living
- d. Legal counseling
- e. Wealth monitoring

ANSWER:

b

51. The last step in the financial planning process is to:

- a. develop financial plans and strategies to achieve goals.
- b. use financial statements to evaluate results of plans and budgets, taking corrective action as required.
- c. implement financial plans and strategies.
- d. redefine goals and revise plans and strategies as personal circumstances change.
- e. periodically develop and implement budgets to monitor and control progress toward goals.

ANSWER:

d

52. Money is an important motivator of personal behavior due to its strong effect on:

- a. self-image.
- b. productivity.
- c. relationships.
- d. attitude.
- e. self-esteem.

ANSWER:

a

53. When setting financial goals, one should typically start by setting:

- a. short-term goals.
- b. intermediate goals.
- c. long-term goals.
- d. goals that are not time-bound.
- e. goals that are very aggressive.

ANSWER:

c

54. Which of the following financial goals is most useful for developing a financial plan?

- a. Make a \$12,000 down payment on an automobile in four years.
- b. Retire with a comfortable lifestyle in 25 years.
- c. Buy a \$125,000 house.
- d. Purchase a \$40,000 boat.
- e. Join a county club upon retirement in 20 years.

ANSWER:

a

55. Financial plans include setting goal dates, which are dates in the:

- a. future when the goals are expected to be achieved.
- b. future when the goals will be compared with other goals that have already been achieved.
- c. past when the goals were revised and redefined.

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- d. past when the goals were set.
- e. future when the goals will be discussed with family members.

ANSWER:

a

56. Which of the following statements about setting long-term goals is true?

- a. The goals should be very ambitious.
- b. The goals should be realistic.
- c. The goals should be attainable in six months to a year.
- d. The goals should be easy to meet.
- e. The goals should be set and remain unchanged.

ANSWER:

b

57. Which of the following is one of the most emotional issues in any relationship, including that with a partner, parents, or children?

- a. Career choices
- b. Hobbies
- c. Friends
- d. Money
- e. Retirement planning

ANSWER:

d

58. The best way for a family to resolve money disputes is to:

- a. ensure that only one person in the family makes decisions regarding money.
- b. consistently communicate openly about money matters with family members.
- c. ensure that individuals do not interfere in other family members' financial matters.
- d. use a third party, who is not a part of the family, to settle disputes.
- e. maintain confidentiality regarding the reasons behind specific decisions.

ANSWER:

b

59. An important part of the conflict resolution process when there are disputes relating to money matters in families is known as:

- a. life-cycle analysis.
- b. personality development.
- c. financial planning.
- d. personal counseling.
- e. stress management.

ANSWER:

c

60. Which of the following statements about money and relationships is true?

- a. It is highly possible to change a partner's financial style.
- b. One of the most important aspects of marriage is financial compatibility.
- c. Money does not cause emotional issues in any relationship.
- d. The best way to resolve a money dispute is to avoid such a discussion.

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- e. Financial planning does not help in resolving conflicts related to money.

ANSWER:

b

61. Which of the following practices helps an individual survive in a financial crisis?

- a. Spending more than their earnings to maintain a good lifestyle
- b. Investing small amounts regularly to achieve long-term financial goals
- c. Establishing an emergency fund with six months' worth of income
- d. Developing financial plans only after reaching the highest tax brackets
- e. Hiring a noncertified financial planner

ANSWER:

c

62. Between the ages of 65 and 80, income tends to:

- a. increase.
- b. decrease.
- c. stabilize.
- d. fluctuate.
- e. decrease and then increase slowly.

ANSWER:

b

63. Which of the following represents the three stages of the financial planning life cycle?

- a. Wealth accumulation, wealth preservation, and wealth transfer
- b. Wealth accumulation, wealth preservation, and wealth depletion
- c. Wealth accumulation, wealth conservation, and wealth transfer
- d. Wealth acquisition, wealth transfer, and wealth depletion
- e. Wealth accumulation, wealth conservation, and wealth maturation

ANSWER:

a

64. Which of the following would NOT be considered an asset?

- a. Savings account
- b. Land
- c. Credit card balance
- d. Jewelry
- e. Money market funds

ANSWER:

c

65. Atul is 60 and has a very high net worth. Atul's most pressing financial concern is probably:

- a. asset acquisition planning.
- b. liability planning.
- c. estate planning.
- d. insurance planning.
- e. savings planning.

ANSWER:

c

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66. In addition to discussing your financial goals with your partner, you must allocate responsibility for what management tasks and decisions?

- a. Skill
- b. Stress
- c. Household
- d. Money
- e. Business-cycle

ANSWER:

d

67. Something we owe and that is measured by the amount of debt we incur is:

- a. an asset.
- b. an estate.
- c. a liability.
- d. insurance.
- e. a goal.

ANSWER:

c

68. The financial planning process helps in:

- a. increasing assets.
- b. increasing debts.
- c. reducing utility.
- d. reducing financial flexibility.
- e. increasing financial risk.

ANSWER:

a

69. Which of the following practices will help in dealing with unexpected negative "financial shocks"?

- a. Purchasing low-utility products
- b. Accumulating debt
- c. Acquiring assets with low financial value
- d. Setting up an emergency fund
- e. Planning for retirement

ANSWER:

d

70. Which of the following is an example of a liquid asset?

- a. A mutual fund
- b. Stocks
- c. An automobile
- d. Land
- e. A savings account

ANSWER:

e

71. Which of the following would be considered real property?

- a. Stocks

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- b. Land
- c. Cash
- d. Bonds
- e. Clothing

ANSWER:

b

72. Managing life, health, and disability insurance is an important part of what type of planning?

- a. Asset acquisition
- b. Tax
- c. Retirement
- d. Estate
- e. Employee benefit

ANSWER:

e

73. Which of the following are included in employee benefit plans?

- a. Career plans
- b. Retirement plans
- c. Tax deferment plans
- d. Personal asset plans
- e. Bankruptcy recovery plans

ANSWER:

b

74. Which of the following statements about investments is true?

- a. As income increases, the need for investment planning decreases.
- b. Keeping money idle is a form of investment.
- c. Higher returns on investment will lead to the accumulation of less wealth.
- d. Investment is measured by the amount of debt incurred.
- e. The length of time for which money is invested is important.

ANSWER:

e

75. Malik invests \$10,000 at a rate of interest of 5 percent for 40 years. Which of the following statements about the return on the investment is true?

- a. Malik will receive more money at the end of 30 years compared to the money received at the end of 40 years.
- b. Malik will receive more money at a 3 percent rate of interest instead of the existing rate.
- c. Malik will receive interest of \$5,000 at the end of 10 years.
- d. Malik will receive no interest on the investment at the end of the investment period.
- e. Malik will receive a significant amount at the end of the investment period, due to the feature of compounding.

ANSWER:

e

76. Tax planning is most commonly done to:

- a. determine the tax penalty.
- b. evade taxes.

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- c. minimize taxes.
- d. pay taxes the person considers to be fair.
- e. learn the tax code.

ANSWER:

c

77. Estate planning involves:

- a. considering how your wealth can be most effectively passed on to your heirs.
- b. determining the income you need to maintain.
- c. the dissolution of all privately held corporations.
- d. the valuation and auctioning of your valuables by hiring a professional tax planner.
- e. planning for retirement.

ANSWER:

a

78. Which of the following will legally reduce an investor's tax liability?

- a. Tax evasion
- b. Tax shelter
- c. Tax penalty
- d. Tax accounting
- e. Tax portfolio

ANSWER:

b

79. Employee benefits may include all of the following EXCEPT:

- a. asset purchases.
- b. life insurance.
- c. child care assistance programs.
- d. pension plans.
- e. subsidized food services.

ANSWER:

a

80. Tax planning is most common among individuals with:

- a. low incomes.
- b. high incomes.
- c. no incomes.
- d. erratic incomes.
- e. decreasing incomes.

ANSWER:

b

81. Which of the following is a typical effect of an economic recession?

- a. An increase in the standard of living
- b. A decrease in unemployment
- c. An increase in the expenditure on luxury goods
- d. A decrease in the value of retirement accounts
- e. An increase in the value of insurance purchased

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ANSWER:

d

82. In what type of plans does an employer allocate a certain amount of money to each employee and lets the employee spend that money for benefits that suit them?

- a. Cafeteria
- b. Fixed-benefit
- c. Estate
- d. Profit-sharing
- e. Saving

ANSWER:

a

83. Which of the following is true of professional financial planners?

- a. They provide services on a fee or commission basis.
- b. They provide services to wealthy investors only.
- c. They set the financial goals of retired investors.
- d. They make financial decisions for investors.
- e. They are most effective during retirement years.

ANSWER:

a

84. The three key groups in the economic environment are:

- a. government, regulators, and business.
- b. government, consultants, and business.
- c. consumers, economists, and business.
- d. consumers, business, and managers.
- e. government, business, and consumers.

ANSWER:

e

85. The government places constraints on the personal financial environment by the use of:

- a. leverage policy.
- b. taxation.
- c. competition.
- d. budgetary deficits.
- e. the free-enterprise system.

ANSWER:

b

86. Which of the following statements about businesses is true?

- a. Businesses provide consumers with goods and services and receive payment in the form of money.
- b. Businesses frame rules and regulations to maintain the law and order in a country.
- c. Businesses determine the kinds of goods and services that a government will use.
- d. Businesses do not interact with other players in the economy.
- e. Businesses are seldom affected by economic cycles.

ANSWER:

a

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87. The federal government's monetary policy:

- a. controls the amount of money in circulation.
- b. increases spending for social services, education, defense, and other programs.
- c. decreases spending to slow the economy.
- d. controls the increase or decrease in taxes.
- e. does all of these.

ANSWER:

a

88. The amount of goods and services each dollar buys at a given time is called:

- a. inflation.
- b. the consumer price index (CPI).
- c. purchasing power.
- d. the gross domestic product (GDP).
- e. the opportunity cost.

ANSWER:

c

89. If your salary increased 4 percent last year and inflation averaged 4 percent, your purchasing power would:

- a. have increased.
- b. have decreased.
- c. have doubled.
- d. have remained the same.
- e. be impossible to tell.

ANSWER:

d

90. A decrease in the gross domestic product (GDP) would indicate that the economy is experiencing:

- a. an expansion.
- b. a contraction.
- c. deflation.
- d. stagflation.
- e. a growth spurt.

ANSWER:

b

91. Which of the following statements describes a consumer?

- a. A consumer is a member of the business group.
- b. A consumer is the central player in the financial planning environment.
- c. A consumer is an important force in the government.
- d. A consumer is an advocacy group that fights corruption in the government.
- e. A consumer is relatively unimportant to business or the government.

ANSWER:

b

92. A strong economy leads to:

- a. a low gross domestic product (GDP).
- b. high tax percentages.

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- c. high employment opportunities.
- d. low tax penalty rates.
- e. a low value of retirement accounts.

ANSWER:

c

93. Following an economic trough, the economy will often enter:

- a. an expansion.
- b. a contraction.
- c. deflation.
- d. a peak.
- e. another trough.

ANSWER:

a

94. The stage in which the economy hits a peak is called:

- a. expansion.
- b. contraction.
- c. stagnation.
- d. recession.
- e. depression.

ANSWER:

a

95. The consumer price index (CPI) is a measure of:

- a. unemployment.
- b. inflation.
- c. stagnation.
- d. recession.
- e. saving.

ANSWER:

b

96. Which of the following statements about Amal is true if the inflation rate is increasing every year by 1 percent and there is no growth in Amal's salary?

- a. Amal can afford to buy more luxury items as prices go down.
- b. Amal's purchasing power will decrease.
- c. Amal's employment opportunities will increase.
- d. The lack of growth in Amal's salary will increase the average inflation rate.
- e. Amal's cost of borrowing will be reduced.

ANSWER:

b

97. Which of the following statements about inflation is true?

- a. The most common measure of inflation is the consumer price index (CPI).
- b. Since 1980, inflation in the United States has risen dramatically.
- c. High inflation is good for interest rates and stock and bond prices.
- d. Inflation has no effect on what we earn in our jobs.

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- e. High rates of inflation tend to drive down the cost of borrowing money.

ANSWER:

a

98. What does an economy experience after a peak?

- a. A convulsion
- b. An expansion
- c. A contraction
- d. Recovery
- e. Prosperity

ANSWER:

c

99. What environment affects the interest rates you pay on your mortgage and credit cards as well as those you earn on savings accounts and bonds?

- a. Economic
- b. Educational
- c. Technological
- d. Social
- e. Legal

ANSWER:

a

100. Which of the following age groups tends to have the highest earnings?

- a. 18–24
- b. 25–34
- c. 35–44
- d. 45–64
- e. 65 and older

ANSWER:

c

101. Typically, an individual's salary will be lower if they live in what type of area?

- a. Metropolitan
- b. Overpopulated
- c. Industrial
- d. Rural
- e. Well-developed

ANSWER:

d

102. When applying for a job within a large nationwide company, you notice that salaries for the same position differ based on geographic region. In which of the following regions would you most likely receive the highest salary?

- a. Small town in the Midwest
- b. Metropolitan area in the Northeast
- c. Rural area in the West
- d. Metropolitan area in the South

ANSWER:

b

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103. Salaries vary across geographical areas because of what type of costs?

- a. Legal
- b. Living
- c. Social
- d. Psychological
- e. Technological

ANSWER:

b

104. Individuals who have more formal education tend to do what in comparison to those with lesser degrees?

- a. Pay more tax penalty
- b. Earn higher annual income
- c. Save less money
- d. Have less wealth
- e. Have careers with less decision-making responsibility

ANSWER:

b

105. Which of the following statements about the earning power of an individual is true?

- a. Income varies across different geographic locations due to varying costs of living.
- b. Heads of households who have less formal education earn more.
- c. Career planning does not help in improving earning potential.
- d. People who are very old have high incomes.
- e. Marital status has no impact on an individual's personal income.

ANSWER:

a

106. Which of the following statements is true of career planning?

- a. It does not require any goal setting.
- b. It is not related to personal financial planning.
- c. It does not influence an individual's lifetime earnings.
- d. It impacts an employer's stability.
- e. It helps in improving professional satisfaction.

ANSWER:

e

107. Generally leading to an increase in income potential in one's career is a person's:

- a. formal education.
- b. social status.
- c. marital status.
- d. corporate loyalty.
- e. family size.

ANSWER:

a