

## Chapter 1—Understanding Personal Finance

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### TRUE/FALSE

1. The level of financial literacy is high among Americans today.

ANS: F  
financial literacy is low among most Americans.

PTS: 1                      DIF: easy                      REF: p. 4

2. People today face the challenge of saving, investing, and managing their own retirement funds.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 4

3. Personal finance is the study of personal and family resources considered important in achieving financial success.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 4

4. Financial success is marked by having high wealth.

ANS: F  
financial success is the achievement of financial aspirations.

PTS: 1                      DIF: moderate                      REF: p. 5

5. By saving and investing, people are much more likely to have funds available for future consumption.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 5

6. One's standard of living comprises all his or her current consumption.

ANS: F  
current consumption is one's level of living. Standard of living is what you aspire to achieve.

PTS: 1                      DIF: moderate                      REF: p. 5

7. Your standard of living is where you would like to be and your level of living is where you actually are.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 5

8. You cannot build financial security or wealth unless you spend less than you earn.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 5

9. A business cycle is a pattern of economic activity that includes an expansion, peak, contraction, and trough.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 7

10. The preferred stage of the economic cycle is the contraction phase.

ANS: F

it is the expansion phase.

PTS: 1                      DIF: easy                      REF: p. 7

11. Since it is impossible to make precise forecasts about economic trends, indicators such as inflation and interest rates can be ignored when planning your finances.

ANS: F

a reasoned and informed estimate of these indicators can and must be included

PTS: 1                      DIF: moderate                      REF: p. 8

12. The typical U.S. recession is marked by an average economic decline of 4 percent.

ANS: F

the average decline has been 2 percent although the most recent has been higher illustrating its severity.

PTS: 1                      DIF: moderate                      REF: p. 7

13. The sum total of all economic activity is measured by the gross domestic product.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 9

14. Procyclical economic indicators are those that predict a positive change in the economy.

ANS: F

procyclical indicators move in the same direction as the economy whether up or down

PTS: 1                      DIF: moderate                      REF: p. 9

15. The index of leading economic indicators is a composite index that suggests the future direction of the U.S. economy.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 10

16. The index of leading economic indicators includes eight components of growth.

ANS: F

it includes 10 components of growth.

PTS: 1                      DIF: easy                      REF: p. 10

17. When the economy begins to show clear signs of a slowdown, it may be a good time to invest in fixed-interest securities.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 13

18. Leading economic indicators are those that do the best job of measuring the state of the economy at any point in time.

ANS: F

leading economic indicators help predict how the economy will do in the future.

PTS: 1

DIF: easy

REF: p. 9

19. Inflation is defined as a steady rise in the general level of prices.

ANS: T

PTS: 1

DIF: easy

REF: p. 10

20. Deflation involves falling prices.

ANS: T

PTS: 1

DIF: easy

REF: p. 10

21. Deflation occurs in an economy when there is a contraction in the money supply.

ANS: T

PTS: 1

DIF: difficult

REF: p. 10

22. In times of moderate to high inflation, people on fixed incomes suffer.

ANS: T

PTS: 1

DIF: easy

REF: p. 11

23. *Real income* and *nominal income* are two terms that reflect the actual purchasing power of one's income.

ANS: F

only real income reflects the purchasing power of one's income by incorporating inflation into the assessment.

PTS: 1

DIF: moderate

REF: p. 11

24. In times of high inflation, personal incomes generally keep up with the rate of inflation.

ANS: F

when inflation is high real incomes cannot keep up.

PTS: 1

DIF: easy

REF: p. 11

25. The consumer price index is a broad measure of changes in the prices of all goods and services purchased for consumption by urban households.

ANS: T

PTS: 1

DIF: easy

REF: p. 11

26. When prices rise, the purchasing power of the dollar declines by the same percentage.

ANS: F

it declines by the reciprocal amount.

PTS: 1

DIF: difficult

REF: p. 12

27. Interest is the price of borrowing money.

ANS: T

PTS: 1

DIF: easy

REF: p. 12

28. Interest rates on home mortgages and other loans tend to fall during times of high inflation.

ANS: F

interest rates rise as lenders try to compensate for the lower purchasing power of the dollar's with which they are repaid.

PTS: 1                      DIF: moderate                      REF: p. 12

29. All things considered, a saver who earns 6 percent interest on a savings account when the rate of inflation is 6 percent is losing real purchasing power.

ANS: T

because of the taxes that are assessed on interest income.

PTS: 1                      DIF: difficult                      REF: p. 11

30. Smart investors recognize that the degree of inflation risk is higher for long-term lending than for short-term lending.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 12

31. When forecasting long-term inflation rates for financial planning purposes, it is better to err on the high side rather than on the low side.

ANS: T                      PTS: 1                      DIF: difficult                      REF: p. 12

32. Interest rates earned on short-term investments are generally lower than interest rates earned on longer-term investments.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 12

33. The rate of interest and the inflation rate generally move in opposite directions; when one goes up, the other goes down.

ANS: F

rates of interest go up and down with the rate of inflation.

PTS: 1                      DIF: moderate                      REF: p. 12

34. When one forgoes buying a new television set because he or she spends the money on college books, the television set is the opportunity cost of buying the books.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 14

35. Opportunity costs are strictly financial in nature and do not involve personal tastes and preferences.

ANS: F

opportunity costs exist in many ways including financial impacts and time.

PTS: 1                      DIF: easy                      REF: p. 14

36. The opportunity cost of a decision is the value of the next best alternative that must be foregone.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 14

37. Marginal cost is the incremental cost of one more incremental unit of something.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 14

38. According to economic theory, people will seek additional utility as long as marginal utility exceeds marginal cost.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 14

39. Most financially successful taxpayers have to pay federal income taxes at the 15 percent marginal tax rate.

ANS: F  
financially successful taxpayers pay a marginal tax rate at 25% or higher although their average tax rate is lower.

PTS: 1                      DIF: easy                      REF: p. 15

40. Financially successful people often pay U.S. federal income taxes at the 25 percent, or higher, marginal tax rate.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 15

41. One's average federal income tax rate is generally higher than one's marginal tax rate.

ANS: F  
Average tax rates are lower than marginal tax rates because the marginal tax rate only applies to the highest segment of income.

PTS: 1                      DIF: difficult                      REF: p. 15

42. Tax-sheltered income is preferable to tax-exempt income.

ANS: F  
with tax-exempt income taxes are never owed but with tax-sheltered income taxes are usually only delayed.

PTS: 1                      DIF: moderate                      REF: p. 14

43. Tax-exempt income is preferable to tax-sheltered income.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 14

44. Simple interest is the interest computed on principal only, without adding the interest to the principal to determine future interest.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 17

45. The simple-interest formula assumes that the interest is withdrawn each year.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 17

46. Compounding occurs when earnings are withdrawn from a savings or investment account each period.

ANS: F

to receive compounding of earning, the earnings must be kept in the account to earn future earnings.

PTS: 1                      DIF: easy                      REF: p. 17

47. Compound interest will produce larger investment values than simple interest.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 17

48. Simple interest is always assumed in time value of money calculations.

ANS: F

time value of money calculations always assume compound interest.

PTS: 1                      DIF: easy                      REF: p. 17

49. Compound interest is the calculation of interest on interest as well as on the original investment.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 17

50. Compounding serves as the basis of all time value of money considerations.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 17

51. Future value is the valuation of an asset projected to the end of a particular time period in the future.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 18

52. Present value is also known as discredited value.

ANS: F

present value is referred to as the discount value.

PTS: 1                      DIF: easy                      REF: p. 20

53. Present value is the current value of an asset (or stream of assets) that will be received in the future.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 20

54. The present value of an annuity is the current worth of a stream of payments to be received in the future.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 20-21

55. An employee benefit is compensation for employment that takes the form of wages, salaries, commissions, or other cash payments.

ANS: F

employee benefits are non-cash compensation such as insurance and retirement plans.

PTS: 1                      DIF: moderate                      REF: p. 21

56. Some employee benefits are tax-sheltered, such as flexible spending accounts and retirement plans.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 21

57. A cafeteria plan, also known as a flexible benefit plan, is an employer-sponsored plan that gives the employee a choice of selecting either cash or one or more qualifying nontaxable benefits.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 21

58. A flexible spending account is an employer-sponsored account that allows employee-paid expenses for medical or dependent care to be paid with employee's pretax dollars rather than after-tax income.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 22

59. The limits on contributions to an HSA savings account are \$3,050 per year for individuals and \$6,150 for families.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 22

60. The tax advantage of a flexible spending account (FSA) occurs because the deducted amounts of salary avoid federal income tax, Social Security taxes, and, in most states, state income taxes, thereby allowing selected personal expenses to be paid with pretax income.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 23

61. For most employees, their employer's health care plan is their most important employee benefit.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 22

62. Funds in a dependent care FSA account may be used to pay for the care of a dependent as long as he or she is younger than age 18.

ANS: F  
the age of the dependent is not at issue. It is the dependency status.

PTS: 1                      DIF: moderate                      REF: p. 22-23

63. Premiums paid by a worker for disability and long-term care insurance are often more expensive when purchased through one's employer.

ANS: F  
they are usually less expensive; sometimes considerably so, due to the employer's contributions.

PTS: 1                      DIF: moderate                      REF: p. 23

64. Health savings accounts (HSAs) are intended for people who elect a high-deductible health care plan.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 22

65. According to Internal Revenue Service (IRS) regulations, unused contributions to a flexible spending account are forfeited and are not returned to the employee—a condition called the "use it or lose it" rule.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 23

66. 401(k), 403(b) and 457 plans are example of tax-sheltered retirement plans offered by employers.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 24

67. An advantage of an employer-sponsored tax-sheltered retirement plan is the tax-deferred growth of contributions and earnings.

ANS: T                      PTS: 1                      DIF: moderate                      REF: p. 24

68. Retirement planning is a process that should begin three to five years before retirement.

ANS: F  
retirement planning should begin as soon as a person becomes financially independent.

PTS: 1                      DIF: moderate                      REF: p. 25

69. Interest, dividends, and capital gains from investments in tax-sheltered retirement plans are tax-free.

ANS: F  
they are tax-sheltered meaning that the taxes are not assessed as the earnings are accumulated.

PTS: 1                      DIF: difficult                      REF: p. 25

70. By law, employers are not permitted to "match" all or part of their employees' contributions, even if they wish to encourage saving for retirement.

ANS: F  
employers are allowed to match employee contributions and many do so and in effect providing free additional money to employees who themselves contribute into the plan.

PTS: 1                      DIF: moderate                      REF: p. 24

71. When faced with a financial problem, you should withdraw money from your retirement plan.

ANS: F  
saving over long periods of time is the most effective way to save for retirement and any withdrawals force one to essentially start over.

PTS: 1                      DIF: moderate                      REF: p. 25

72. Fee-based financial planners/brokers charge up-front fees for providing services and charge commissions on any securities trades or insurance purchases that they conduct on your behalf.

ANS: T                      PTS: 1                      DIF: easy                      REF: p. 28

73. A commission-only financial planner/broker charges an up-front fee for providing services.

ANS: F  
commission-only financial planners are compensated solely on commissions they receive from the financial products they sell

PTS: 1                      DIF: easy                      REF: p. 28

74. By law, all financial planners must be Certified Financial Planners (CFPs).



ANS: F

obtaining any type of certification by professionals giving financial advice is strictly voluntary.

PTS: 1

DIF: easy

REF: p. 27

75. You would want your financial planner to provide you with an investment policy statement that details your investment philosophy, your financial situation, and the risks you are willing to take, as well as what the advisor will do for you.

ANS: T

PTS: 1

DIF: easy

REF: p. 28

## MULTIPLE CHOICE

76. The study of personal finance includes
- a. financial and career planning.
  - b. risk management.
  - c. tax planning.
  - d. all of these.

ANS: D

PTS: 1

DIF: easy

REF: p. 4

77. Mike and Patty are saving monthly so they can buy a home, but they are currently renting an apartment. The apartment is part of
- a. their standard of living.
  - b. their level of living.
  - c. their savings.
  - d. personal inflation rate.

ANS: B

because it is part of their current financial situation rather than what they aspire to.

PTS: 1

DIF: moderate

REF: p. 5

78. Financial objectives are rarely achieved without restraining
- a. current consumption.
  - b. savings.
  - c. investment.
  - d. future earnings.

ANS: A

PTS: 1

DIF: easy

REF: p. 5

79. Financial success is defined as the achievement of
- a. a financially secure retirement.
  - b. financial aspirations that are desired, planned, or attempted.
  - c. vast wealth.
  - d. a comfortable lifestyle.

ANS: B

not everyone describes success as being wealthy.

PTS: 1

DIF: easy

REF: p. 5

80. Which of the following should be the easiest for a person to forecast?

- a. Income
- b. Inflation
- c. Interest rates
- d. Economic growth

ANS: A

primarily because the other options are beyond one's personal control.

PTS: 1                      DIF: moderate                      REF: p. 7-9

81. The preferred phase of the economic cycle is
- a. expansion.
  - b. peak.
  - c. trough.
  - d. contraction.

ANS: A                      PTS: 1                      DIF: easy                      REF: p. 7

82. During expansion, which of the following is high?
- a. Unemployment
  - b. Inflation
  - c. Interest rates
  - d. Retail sales

ANS: D                      PTS: 1                      DIF: moderate                      REF: p. 7

83. The economic phase with conditions making it easy for consumers to buy homes, cars, and other goods is called
- a. expansion.
  - b. trough.
  - c. peak.
  - d. contraction.

ANS: A                      PTS: 1                      DIF: easy                      REF: p. 7

84. Interest rates and inflation climb at what phase of the economic cycle?
- a. expansion.
  - b. peak.
  - c. contraction.
  - d. trough.

ANS: B                      PTS: 1                      DIF: moderate                      REF: p. 7

85. Which of the following statements is correct?
- a. Long-term interest rates are generally higher than short-term interest rates.
  - b. Stock market investors are positively affected when inflation rises.
  - c. The degree of inflation risk is higher for short-term lending.
  - d. During times of high inflation, interest rates on new loans for cars, homes, and credit cards fall.

ANS: A

because lenders are less able to make accurate predictions about inflation.

PTS: 1                      DIF: moderate                      REF: p. 12

86. The entire business cycle normally takes \_\_\_\_ years.

- a. two to three
- b. four
- c. six
- d. ten to twelve

ANS: C                      PTS: 1                      DIF: moderate                      REF: p. 8

87. A good time to invest in stocks is when the economy is
- a. in the prosperity of the expansion stage.
  - b. in the trough of a recession.
  - c. in a depression.
  - d. entering the recovery stage.

ANS: B  
as stock prices are lowest at this point and poised for a rebound.

PTS: 1                      DIF: difficult                      REF: p. 13

88. The two statistics one should track to understand the future direction of the economy are
- a. interest rates and inflation.
  - b. interest rates and the gross domestic product.
  - c. the consumer confidence index and the index of leading economic indicators.
  - d. inflation and the index of leading economic indicators.

ANS: C                      PTS: 1                      DIF: difficult                      REF: p. 10

89. The statistic that measures the value of all goods and services produced in the United States is the
- a. consumer price index.
  - b. index of leading economic indicators.
  - c. federal funds rate.
  - d. gross domestic product.

ANS: D                      PTS: 1                      DIF: moderate                      REF: p. 9

90. Which of the following economic indicators tends to move in the opposite direction of where the economy is headed?
- a. procyclical indicators
  - b. employment rate
  - c. gross domestic product
  - d. counter cyclical indicators

ANS: D                      PTS: 1                      DIF: moderate                      REF: p. 9

91. Rick Palmer received a \$2,500 raise this year. This increased his salary as an associate TV producer from \$45,000 to \$47,500. What percentage increase in nominal income did Rick receive?
- a. 2.5 percent
  - b. 5.3 percent
  - c. 5.6 percent
  - d. 7.8 percent

ANS: C  
(\$2,500 / \$45,000).

PTS: 1                      DIF: moderate                      REF: p. 11

92. Jeremiah and Sara's family income increased from \$60,000 to \$63,000 in the past year. Inflation was 2 percent over the same time period. Which of the following is true regarding Jeremiah and Sara's income?
- a. Their nominal income increased 4.8 percent.
  - b. Their nominal income increased 5 percent.
  - c. Their real income decreased 2 percent.
  - d. Their real income decreased 5 percent.

ANS: B

$\$3,000 / \$60,000$

PTS: 1

DIF: moderate

REF: p. 11

93. How much is Jeremiah and Sara's real income after the \$3,000 increase in income?
- a. \$63,000
  - b. \$61,765
  - c. \$60,000
  - d. \$58,824

ANS: B

$\$63,000 / (1.0 + 0.02)$

PTS: 1

DIF: difficult

REF: p. 11

94. If your income increased from \$23,000 to \$26,000 during a period when the rate of inflation was 4 percent, your real income after the raise was
- a. \$23,000.
  - b. \$24,000.
  - c. \$25,000.
  - d. \$26,000.

ANS: C

$\$26,000 / (1 + 0.04)$

PTS: 1

DIF: difficult

REF: p. 11

95. Arvi, a college teaching assistant, received a raise of \$650 from \$13,000 to \$13,650 this year. If inflation was 2 percent over the same period, which of the following is true?
- a. Arvi's increase in real income was \$650.
  - b. Arvi's increase in real income was 7 percent.
  - c. Arvi's increase in real income was \$382.
  - d. Arvi's increase in real income was 3.3 percent.

ANS: C

$(\$13,650 / 1.02) - \$13,000$

PTS: 1

DIF: difficult

REF: p. 11

96. The U.S. government measures inflation using
- a. the gross domestic product.
  - b. the index of leading economic indicators.
  - c. the consumer price index.
  - d. consumer confidence index.

ANS: C

PTS: 1

DIF: easy

REF: p. 11

97. If the consumer price index was 199 in 2006 and 212 in 2009, how much did prices increase during this time period?
- a. 6.1 percent
  - b. 6.5 percent
  - c. 11 percent
  - d. 13 percent

ANS: B

$$(212 - 199) / 199$$

PTS: 1                      DIF: moderate                      REF: p. 12

98. If the consumer price index was 100 in 1984 and 212 in 2009, how much did prices increase during this period?
- a. 44 percent
  - b. 56 percent
  - c. 112 percent
  - d. 212 percent

ANS: C

$$(212 - 100) / 100$$

PTS: 1                      DIF: moderate                      REF: p. 12

99. If the consumer price index was 100 in 1984 and 212 in 2009, the purchasing power of the dollar
- a. fell 112 percent.
  - b. fell 52.8 percent.
  - c. rose 112 percent.
  - d. rose 52.8 percent.

ANS: B

$$1.0 - (100 / 212)$$

PTS: 1                      DIF: difficult                      REF: p. 12

100. The rate of increase in prices of items purchased by an individual is called the
- a. personal interest rate.
  - b. rate of inflation.
  - c. personal inflation rate.
  - d. consumer price index.

ANS: C                      PTS: 1                      DIF: moderate                      REF: p. 12

101. A rising inflation rate is good news for
- a. stock investors.
  - b. borrowers.
  - c. savers.
  - d. lenders.

ANS: B

as their loans will be paid back with dollars that are worth less.

PTS: 1                      DIF: moderate                      REF: p. 12

102. Which of the following is the one key interest rate to focus on when trying to forecast interest rate trends in the future?
- a. Prime rate
  - b. Federal funds rate
  - c. Discount rate
  - d. Mortgage rate

ANS: B                      PTS: 1                      DIF: moderate                      REF: p. 12

103. Why do rising interest rates generally depress stock prices?
- a. Businesses have to pay higher interest rates to borrow money, thus reducing their profits.
  - b. Stock investors tend to take their money out of the stock market and invest in interest-paying investments.
  - c. Future earnings will not be worth as much as today.
  - d. All of these.

ANS: D                      PTS: 1                      DIF: difficult                      REF: p. 12

104. Which of the following is an example of a financial opportunity cost?
- a. Time
  - b. Effort
  - c. Health
  - d. Interest

ANS: D                      PTS: 1                      DIF: moderate                      REF: p. 14

105. Lili spent \$120 on a new sweater rather than using this money to buy her personal finance textbooks. The cost of doing without the textbooks is called the \_\_\_\_ cost of buying the sweater.
- a. marginal
  - b. utility
  - c. opportunity
  - d. present

ANS: C                      PTS: 1                      DIF: moderate                      REF: p. 14

106. Bill and Alma are shopping for their first home. They have found two houses that are nearly identical except for their locations. One house costs \$250,000 and is 15 miles from their places of employment. The second house costs \$275,000, but it is within 5 miles of where they both work. Now Bill and Alma are trying to decide if living 10 miles closer to their workplaces is worth the extra \$25,000 in the cost of the house. Which decision-making concept are they using?
- a. Opportunity cost
  - b. Marginal analysis
  - c. Time value of money
  - d. Total utility

ANS: B                      PTS: 1                      DIF: moderate                      REF: p. 14-15

107. Brice is going to purchase a computer. He has decided on everything except the monitor size. The unit with the 15-inch monitor costs \$1,500 while the unit with the 19-inch monitor costs \$1,750. In making this decision, which concept should Brice use?
- a. Marginal utility
  - b. Time value of money
  - c. Total utility
  - d. Marginal tax rates

ANS: A                      PTS: 1                      DIF: moderate                      REF: p. 14-15

108. Dan just received a \$2,000 end-of-year bonus from his employer. If he pays a 25 percent marginal tax rate for federal income taxes, his state income tax is 5 percent, and the Social Security tax rate is 7.65 percent, approximately how much of the \$2,000 bonus will Dan have left to spend on holiday gifts?
- a. \$2,000
  - b. \$1,400
  - c. \$1,247
  - d. \$753

ANS: C

$$\$2000 \times (1.0 - .25 - .05 - .07650)$$

PTS: 1

DIF: difficult

REF: p. 15

109. Donald is a college student who has \$4,000 in savings that he earned from his summer job. He plans to leave the \$4,000 in a 6 percent certificate of deposit (CD) for three years, but his banker has asked Donald whether he wants the interest earned on the CD mailed to him at the end of each year or reinvested in the CD. Approximately how much more will Donald earn if he decides to reinvest the interest rather than withdrawing the interest income each year?
- a. \$14
  - b. \$44
  - c. \$144
  - d. \$240

ANS: B

$$[(\$4,000 \times 1.06 \times 1.06 \times 1.06) - \$4,000] - (\$4,000 \times .06 \times 3)$$

PTS: 1

DIF: difficult

REF: p. 17

110. Grandmother Smith has just put \$12,000 into an investment earning 6 percent a year for her granddaughter's college education. Approximately how much will be in the account in ten years assuming all the interest is left in the account?
- a. \$19,200
  - b. \$21,490
  - c. \$16,320
  - d. \$21,259

ANS: B

$$\$12,000 \times 1.7908 \text{ from Appendix A.1 or } \$12,000 \times 1.06^{10}$$

PTS: 1

DIF: difficult

REF: p. 17

111. Betty and Bill just won \$10,000 in the Pennsylvania state lottery. They decide to spend \$3,000 now and put the remaining \$7,000 in an investment earning 8 percent compounded annually. If they use the money in that investment for a vacation in five years, approximately how much will they have available to spend on that vacation?
- a. \$14,693
  - b. \$10,342
  - c. \$10,285
  - d. \$9,800

ANS: C

$$\$7,000 \times 1.4693 \text{ from Appendix A.1 or } \$7,000 \times 1.08^5$$

PTS: 1

DIF: difficult

REF: p. 17-18

112. Housing values are appreciating at a rate of 3 percent a year. Approximately how much will your \$100,000 house be worth in ten years if this rate of appreciation continues?
- a. \$134,390
  - b. \$146,320
  - c. \$155,080
  - d. \$174,410

ANS: A

$\$100,000 \times 1.3439$  from Appendix A.1 or  $\$100,000 \times 1.03^{10}$

PTS: 1                      DIF: moderate                      REF: p. 17-18

113. Most people save for \_\_\_\_ goals by putting away a series of payments.
- a. short-term
  - b. unachievable
  - c. long-term
  - d. tax-free

ANS: C                      PTS: 1                      DIF: easy                      REF: p. 17

114. Paul invested \$10,000 in a security that will double in value in ten years. Approximately what annual rate of return is this investment making?
- a. 10.0 percent
  - b. 7.2 percent
  - c. 6.3 percent
  - d. 5.8 percent

ANS: B

based on the Rule of 72.

PTS: 1                      DIF: moderate                      REF: p. 19

115. Over the past few years, the price of houses has been increasing at an annual rate of 4 percent nationally. How many years will it take for costs to double at this rate?
- a. 7
  - b. 9
  - c. 15
  - d. 18

ANS: D

$72 / 4$

PTS: 1                      DIF: moderate                      REF: p. 19

116. Lisa Carson has the opportunity to receive \$12,000 now or \$15,000 in four years. If Lisa can earn 6 percent on her investments, what is the present value of the \$15,000 payment?
- a. \$15,000
  - b. \$13,785
  - c. \$11,881
  - d. \$9,505

ANS: C

$\$15,000 \times 0.7921$  from Appendix A.2 or  $\$15,000 / 1.06^4$



PTS: 1                      DIF: difficult                      REF: p. 20

117. \_\_\_\_ is the current value of an asset that will be received in the future.
- a. Present value
  - b. Future value
  - c. A benefit
  - d. Inflation

ANS: A                      PTS: 1                      DIF: easy                      REF: p. 20

118. The present value of an annuity is the \_\_\_\_ worth of a stream of payments to be received in the future.
- a. inflated
  - b. estimated
  - c. previous
  - d. current

ANS: D                      PTS: 1                      DIF: moderate                      REF: p. 20-21

119. Which form of compensation is *not* considered an employee benefit?
- a. Paid holidays
  - b. Commissions
  - c. Health insurance
  - d. Retirement plan

ANS: B                      PTS: 1                      DIF: moderate                      REF: p. 21

120. When contemplating taking a job or switching jobs, what should be considered?
- a. Comparing salary offers from employers located in cities that have different costs of living
  - b. Flexible spending accounts
  - c. Employer-sponsored qualified retirement plans
  - d.** All of these

ANS: D                      PTS: 1                      DIF: moderate                      REF: p. 21-26

121. Paying expenses with pretax dollars
- a. increases taxable income.
  - b. increases take-home pay.
  - c. increases after-tax income.
  - d. is only a good idea for high income earners.

ANS: C                      PTS: 1                      DIF: moderate                      REF: p. 22

122. A flexible spending account (FSA) is
- a. a vehicle that allows employee-paid expenses for medical or dependent care to be paid with pretax dollars.
  - b. available through all employers.
  - c. funded by an employer.
  - d. taxable income received by the employee if not used by the end of the year.

ANS: A                      PTS: 1                      DIF: moderate                      REF: p. 22

123. What statement is *not* accurate regarding participation in an FSA?
- a. Funds in a dependent care FSA account may be used to pay only for the care of a dependent younger than age 21.
  - b. Unused amounts are forfeited and are not returned to the employee.
  - c. The maximum annual contribution is \$5,000 for a dependent-care FSA.

- d. The maximum annual contribution limits are usually \$2,000 to \$3,000 for a medical-care FSA.

ANS: A                      PTS: 1                      DIF: moderate                      REF: p. 22-23

124. What statement is *not* accurate regarding participation in an HSA?
- a. A health savings account is intended for people who have a high-deductible health care plan.
  - b. Employees make tax-deductible contributions to their HSAs to be used for eligible expenses.
  - c. The employee invests HSA funds and the money in the account grows tax-free.
  - d. Employers are prohibited from making contributions to their employees' HSA.

ANS: D                      PTS: 1                      DIF: moderate                      REF: p. 22

125. In an employer-sponsored retirement plan, interest, dividends, and capital gains earned from the funds invested in the plan are taxed
- a. only after funds are withdrawn from the plan, if at all.
  - b. with each payment.
  - c. annually.
  - d. on a quarterly basis.

ANS: A                      PTS: 1                      DIF: moderate                      REF: p. 25

126. Which of the following is a way to receive free money to deposit into a tax-sheltered retirement plan?
- a. Start early to boost your retirement.
  - b. Take advantage of your employer's "match."
  - c. Making early withdrawals from a tax-sheltered retirement plan.
  - d. Opening an HSA.

ANS: B                      PTS: 1                      DIF: moderate                      REF: p. 24

127. A single person with a monthly taxable income of \$7,000 in the 28 percent marginal tax bracket forgoes consumption and instead places \$450 into a tax-sheltered retirement plan every month. What are the *yearly* tax savings due to these retirement contributions?
- a. \$1,120
  - b. \$5,400
  - c. \$1,512
  - d. \$1,316

ANS: C  
\$5400 x 0.28

PTS: 1                      DIF: difficult                      REF: p. 24

128. Which of the following is not an advantage of participating in your employer's retirement plan?
- a. Tax-deductible contributions
  - b. Employer's matching contributions
  - c. Tax-deferred growth
  - d. Higher take home pay

ANS: D                      PTS: 1                      DIF: easy                      REF: p. 23-25

129. Employer-sponsored retirement plans include all of the following *except*
- a. 401(k).
  - b. 403(b).

- c. 457.
- d. IRA.

ANS: D                      PTS: 1                      DIF: easy                      REF: p. 24

130. Which of the following statement(s) is (are) correct?
- a. Fee-only planners sell financial products, such as stocks or insurance.
  - b. Commission-only financial planners/brokers live solely on the commissions they receive on the financial products (such as investments or insurance) they sell to their clients.
  - c. Fee-only financial planners may benefit from steering a client to a specific financial product.
  - d. From the point of view of the client there is no difference between a fee-only planner and a commission-only planner

ANS: B                      PTS: 1                      DIF: difficult                      REF: p. 28

131. If you receive tax-sheltered income, it means that
- a. you will never have to pay taxes on the income.
  - b. the income has already been taxed.
  - c. the taxes on the income will be deferred until a later date.
  - d. taxes will be assessed on the state rather than federal level.

ANS: C                      PTS: 1                      DIF: moderate                      REF: p. 15

132. During a recession, people and business are likely to engage in \_\_\_\_\_; meaning that their use of credit will decrease.
- a. leveraging.
  - b. deleveraging.
  - c. compounding.
  - d. tax-sheltering.

ANS: B                      PTS: 1                      DIF: moderate                      REF: p. 8

133. Occasionally, the economy will dip into a trough before it has reached a new peak after a previous trough. This phenomena is called a
- a. depression.
  - b. recession.
  - c. double-dip recession
  - d. stagflation.

ANS: C                      PTS: 1                      DIF: moderate                      REF: p. 8

134. A method by which one can compare cash flows across time, either as what a future cash flow is worth today (present value) or what an investment made today will be worth in the future (future value) is called
- a. time-value of money
  - b. compounding
  - c. simple interest
  - d. marginal analysis.

ANS: A                      PTS: 1                      DIF: moderate                      REF: p. 16