

CFA[®] Candidate Self-Assessment Test

The CFA Program is postgraduate. The readings assigned in the study program and the questions on the CFA examinations are geared for individuals who are prepared to deal with “masters”-level coursework. Although many candidates enter the program with a business school education, others may have a liberal arts background. No prerequisite courses of study are specified for entering the CFA Program, but candidates should be aware that the assigned readings in many topic areas are beyond a basic, introductory level.

The Level I Financial Statement Analysis material is directed at an intermediate/advanced level of understanding. Before entering the CFA Program, candidates should be familiar with financial accounting methods and financial statements. Candidates without a strong accounting background or who need to refresh their accounting knowledge should review an intermediate financial accounting textbook or enroll in a local university financial accounting course.

The Level I Economic Analysis material is also directed at an intermediate level of understanding. Before entering the program, candidates already should be familiar with the principles of macroeconomics, microeconomics, and the monetary system. If candidates do not have this educational background or they wish to refresh their understanding of this material, a review of an introductory level textbook or enrollment in a local university economics survey course is appropriate.

The Level I curriculum in general assumes a basic understanding of financial markets and instruments. Before entering the program, candidates should be familiar with the basic characteristics of equity and fixed income markets and securities. Candidates without that familiarity should review an introductory level textbook that addresses financial markets and instruments.

The self-assessment test is designed to help candidates determine their need to review pre-CFA materials. An answer key is provided at the end of the test. Candidates scoring less than 70 percent correct in any one topic area should commit to additional study time preparing for that area *prior to* or *in conjunction with* the CFA study program.

CFA[®] Candidate Self-Assessment Test Questions

FINANCIAL STATEMENT ANALYSIS: 30 Questions

Note to candidates: Questions 1 through 30 are based on U.S. generally accepted accounting principles (GAAP) unless otherwise noted.

1. Accrual accounting techniques are used to:
 - A. assign revenues and expenses to the appropriate accounting period.
 - B. record the anticipated effects of actions that may occur at a future date.
 - C. report the results of actions whose monetary effects are difficult to estimate.
 - D. allocate nonoperating revenues and expenses to the appropriate business unit.

2. Which of the following is **NOT** considered an asset?
 - A. Inventory
 - B. Trademarks
 - C. Retained earnings
 - D. Accounts receivable

Use the information in the following table to answer Questions 3 and 4.

Black Company
Balance Sheet
December 31, 200X

<i>Assets</i>			
Cash		\$100,000	
Short-term investments		50,000	
Accounts and notes receivable		130,000	
Inventory		140,000	
Land		170,000	
Building	\$200,000		
less accumulated depreciation	<u>(40,000)</u>	160,000	
Trademarks		110,000	
Total Assets			\$860,000
<i>Liabilities</i>			
Notes payable (due in 3 months)		\$80,000	
Accounts payable		40,000	
Accrued salaries payable		10,000	
Mortgage payable (due in 8 years)		180,000	
Total Liabilities			\$310,000
<i>Stockholders' Equity</i>			
Common stock		\$500,000	
Retained earnings		50,000	
Total Stockholders' Equity			\$550,000
Total Liabilities and Stockholders' Equity			\$860,000

3. The total amount of Black Company's assets to be classified as current assets is:
 - A. \$150,000.
 - B. \$280,000.
 - C. \$420,000.
 - D. \$590,000.
4. The net amount of Black Company's earnings that has been reinvested in the company since the company's inception is *closest* to:
 - A. \$50,000.
 - B. \$100,000.
 - C. \$500,000.
 - D. \$550,000.
5. When accounting for merchandising businesses, gross margin equals the difference between:
 - A. net sales and cost of goods sold.
 - B. net sales and operating expenses.
 - C. gross sales and the sum of returns and allowances.
 - D. net sales and the sum of cost of goods sold and operating expenses.
6. Which of the following would **NOT** contribute to the difference between gross sales and net sales?
 - A. Cash refunds for returned products.
 - B. Discounts from listed prices for delayed shipping.
 - C. Allowances off selling prices for defective products.
 - D. Sales made on credit rather than for immediate payment.
7. Classifying an investment as short-term or long-term depends primarily on:
 - A. the dollar amount of the investment.
 - B. the length of time the investor has held the investment.
 - C. whether a liquid market exists for selling the investment.
 - D. the length of time the investor expects to hold the investment.
8. Under the allowance method for accounting for uncollectible accounts:
 - A. losses from bad debts are recognized when defaults occur.
 - B. estimated losses from potentially uncollectible debt are amortized over the life of the obligation.
 - C. loans to high-risk borrowers are recorded at a discount relative to their stated principal amounts.
 - D. losses from bad debts are estimated for the same period in which the corresponding credit sales occur.
9. A company's cost of inventory purchases was \$250,000 during the year, its ending inventory was \$80,000, and its beginning inventory was \$100,000. The company's cost of goods sold was *closest* to:
 - A. \$170,000.
 - B. \$270,000.
 - C. \$330,000.
 - D. \$370,000.

10. Inventory valuation methods rely *primarily* on assumptions about the flow of:
- costs.
 - values.
 - money.
 - resale prices.
11. For a company with new fixed assets, which of the following combinations of accounting practices will most likely lead to the highest reported earnings in an inflationary environment?
- | <u>Depreciation Method</u> | <u>Inventory Method</u> |
|-----------------------------|----------------------------|
| A. Straight-line | First in, first out (FIFO) |
| D. Straight-line | Last in, first out (LIFO) |
| B. Double-declining-balance | First in, first out (FIFO) |
| C. Double-declining-balance | Last in, first out (LIFO) |
12. In a period of rising prices, which of the following inventory methods generally results in the lowest reported net income?
- FIFO method.
 - LIFO method.
 - Average-cost method.
 - Specific-identification method.
13. In a period of rising prices and stable inventory quantities, compared to a company that uses the FIFO inventory valuation method, a company using LIFO is *likely* to have higher:
- inventory.
 - income taxes.
 - current assets.
 - cost of goods sold.
14. If a company's ending inventory is understated by \$3,000 and beginning inventory is overstated by \$5,000, the company's operating income will *most likely* be:
- overstated by \$2,000.
 - overstated by \$8,000.
 - understated by \$2,000.
 - understated by \$8,000.
15. When applying the lower-of-cost-or-market rule to inventory, market generally refers to:
- resale value.
 - original cost.
 - current replacement cost.
 - original cost less physical deterioration.
16. A company bought a truck on January 1 for \$30,000. The truck has a five-year estimated useful life and a \$5,000 residual value. Under the straight-line depreciation method, the asset's carrying value for financial reporting purposes after two years is *closest* to:
- \$16,000.
 - \$18,000.
 - \$20,000.
 - \$21,000.

17. For purposes of determining the amount of a capital expenditure, the acquisition cost of equipment would **NOT** include:
- A. transportation cost.
 - B. insurance cost during transit.
 - C. cost of testing equipment during installation.
 - D. repair cost of damage incurred during installation.
18. Depreciation differs from other types of expenses in that depreciation:
- A. can be measured more precisely.
 - B. does not require an immediate cash outlay.
 - C. is not deductible if it would result in a net loss.
 - D. can be avoided if the company acquires used assets.
19. If a company issued bonds at a discount, the discount is amortized over the life of the bonds and:
- A. decreases the periodic interest payment below the interest expense charged.
 - B. increases the periodic interest expense charged above the interest payment made.
 - C. increases the periodic interest payment made above the interest expense charged.
 - D. decreases the periodic interest expense charged below the interest payment made.
20. On a company's balance sheet, which of the following would **NOT** be listed as contributed capital?
- A. Common stock
 - B. Preferred stock
 - C. Retained earnings
 - D. Paid-in-capital in excess of par value
21. Which of the following accurately describes the effects of a purchase of treasury stock on a company's assets and stockholders' equity?
- | <u>Assets</u> | <u>Stockholders' Equity</u> |
|---------------|-----------------------------|
| A. Decreased | Decreased |
| B. Decreased | Unchanged |
| C. Unchanged | Decreased |
| D. Unchanged | Unchanged |
22. If a corporation declares and pays a dividend, this transaction will:
- A. increase liabilities.
 - B. decrease net income.
 - C. not affect total assets.
 - D. reduce stockholders' equity.
23. A company's assets and stockholders' equity are *most likely* to be reduced by:
- A. stock splits.
 - B. cash dividends.
 - C. stock dividends.
 - D. reverse stock splits.

24. The financial results from a discontinued operation should be reflected on a company's financial statements by:
- A. discussing the effects in a footnote.
 - B. adjusting the company's reported costs.
 - C. adjusting the company's reported net revenue.
 - D. reporting the effects separately on the income statement.

Questions 25 through 27 should be answered in the context of a statement of cash flows and using the following data for a company:

Cash payments for interest	\$ 12
Retirement of common stock	32
Cash payments to merchandise suppliers	85
Purchase of land	8
Sale of equipment	30
Payment of dividends	37
Cash payment for salaries	35
Cash collection from customers	260
Purchase of equipment	40

25. The company's cash flows from *operating* activities are *closest* to:
- A. \$91.
 - B. \$128.
 - C. \$140.
 - D. \$175.
26. The company's cash flows from *investing* activities are *closest* to:
- A. -\$67.
 - B. -\$48.
 - C. -\$18.
 - D. -\$10.
27. The company's cash flows from *financing* activities are *closest* to:
- A. -\$81.
 - B. -\$69.
 - C. -\$49.
 - D. -\$37.

28. Which of the following is **NOT** an accurate statement of the balance sheet equation?
- A. Assets – Liabilities = Owners' Equity.
 - B. Assets – Owners' Equity = Liabilities.
 - C. Assets = Liabilities + Owners' Equity.
 - D. Assets = Liabilities – Owners' Equity.
29. Which of the following financial statements presents information about a business at a point in time?
- A. Balance sheet
 - B. Income statement
 - C. Statement of cash flows
 - D. Statement of retained earnings
30. The responsibilities of the auditor of a company's financial statements do **NOT** include a requirement to:
- A. confirm assets and liabilities.
 - B. examine the company's internal control systems.
 - C. verify that the financial statements are free from any error.
 - D. agree that management's choice of accounting principles is appropriate.

ECONOMICS: 30 Questions

31. When comparing gross national product (GNP) and gross domestic product (GDP), GDP is *most likely* to exclude:
- A. net exports.
 - B. foreign security transactions.
 - C. income earned by citizens abroad.
 - D. payments for national income taxes.
32. Using the expenditure approach, gross domestic product includes gross:
- A. income taxes paid.
 - B. salaries and wages paid.
 - C. imports from foreigners.
 - D. private domestic investment.
33. An analyst, calculating the gross domestic product for an economy, is *most likely* to include:
- A. sales of services.
 - B. financial transactions.
 - C. sales of intermediate goods.
 - D. government transfer payments.
34. The presence of a surplus of a good in a market is *most likely* to result in a(n):
- A. decrease in supply.
 - B. decrease in demand.
 - C. increase in supply elasticity.
 - D. increase in quantity demanded.

35. An analyst interested in understanding movements in the general level of prices throughout the economy is *most likely* to use the:
- A. consumer price index (CPI).
 - B. gross domestic product (GDP) deflator.
 - C. weighted average of the CPI and the GDP deflator.
 - D. correlation coefficient between the CPI and the GDP deflator.
36. Which of the following is a limitation of GDP as a measure of aggregate economic activity? GDP excludes:
- A. imports to foreigners.
 - B. production of household services.
 - C. governmental consumption of goods.
 - D. private investment in depreciable assets.
37. Which of the following statements about phases of the business cycle is *most accurate*?
- A. During an expansion, real output grows and unemployment increases.
 - B. During contraction, real output declines and unemployment decreases.
 - C. The business peak is the highest output (measured in GDP) of an expansion.
 - D. The recessionary trough measures deviations of real GDP from the trend line.
38. An analyst calculating the unemployed rate is *most likely* to classify as unemployed persons who are:
- A. retired.
 - B. not looking for work.
 - C. temporarily laid off from a job.
 - D. working in their own households.
39. Frictional unemployment results from:
- A. inflexible wages in the marketplace.
 - B. recessionary business conditions and inadequate aggregate demand for labor.
 - C. structural characteristics of the economy that create difficulties for job seekers in finding employment and for employers in hiring workers.
 - D. constant changes in the economy that prevent qualified unemployed workers from being immediately matched up with existing job openings.
40. To be useful, a measure of inflation for an economy would *most likely* reflect information about the change in prices of:
- A. goods only.
 - B. goods and services only.
 - C. goods, services, and financial assets only.
 - D. goods, services, financial assets, and real assets.
41. If the consumer price index is 252 this year compared with 240 last year, the rate of inflation for the year is *closest* to:
- A. 4.76%.
 - B. 4.88%.
 - C. 5.00%.
 - D. 12.00%.

42. A period when an economy is experiencing substantial inflation and either a declining or slow rate of growth in output is called:
- A. deflation.
 - B. stagflation.
 - C. depression.
 - D. contraction.
43. Which of the following is **NOT** a source of adverse effects of inflation on an economy?
Inflation:
- A. distorts the information delivered by prices.
 - B. affects product prices without changing underlying resource prices, such as wages, in the long run.
 - C. increases the uncertainty accompanying investment and other activities involving future payments.
 - D. causes wasted resources as individuals attempt to prevent the erosion of their income and wealth as a result of the inflation.
44. Aggregate demand is *least likely* to increase as a result of a(n):
- A. increase in real wealth.
 - B. decrease in the real rate of interest.
 - C. increase in the expected rate of inflation.
 - D. increase in the exchange rate value of the nation's currency.
45. Which of the following factors will *decrease* long-run aggregate supply?
- A. Supply shocks.
 - B. A reduction in the supply of resources.
 - C. An improvement in technology and productivity.
 - D. Intensified competition in markets for goods and services.
46. Which of the following factors is *least likely* to play a role in the self-correcting mechanisms that help stabilize the economy? The pattern of:
- A. price adjustments in resource markets.
 - B. changes in employment levels in labor markets.
 - C. interest rate adjustments in loanable funds markets.
 - D. changes in consumption in response to fluctuations in income.
47. The views of the classical economists and the Keynesian model differ with respect to the:
- A. amount of flexibility in wages and prices.
 - B. level of the natural rate of unemployment.
 - C. appropriate definition of the money supply.
 - D. determinants of the long-run aggregate supply curve.
48. Which of the following conditions is present when macroeconomic equilibrium is achieved in the Keynesian model?
- A. Autonomous expenditures are zero.
 - B. Planned imports and planned exports are equal.
 - C. Government spending levels and taxes are equal.
 - D. Planned expenditures and current output are equal.

49. An analyst has gathered the following consumption information:

<u>Income</u>	<u>Current Consumption</u>
\$20,000	\$19,000
24,000	22,000

The marginal propensity to consume (MPC) is *closest* to:

- A. 0.50.
 - B. 0.75.
 - C. 0.86.
 - D. 1.33.
50. According to the Keynesian model, if the marginal propensity to consume is 0.8, an independent increase in investment expenditures of \$10 billion is *most likely* to lead to an increase in the equilibrium level of aggregate income of:
- A. \$8 billion.
 - B. \$12.5 billion.
 - C. \$50 billion.
 - D. \$80 billion.
51. The law of demand states that an:
- A. increase in price can be expected as consumers demand more units of a product.
 - B. inverse relationship exists between the price and the amount of a good purchased.
 - C. increase in price will result from an increase in demand for a good in scarce supply.
 - D. increase in the quantity of a good available will occur when the price of the good increases.
52. The law of supply states that:
- A. a direct relationship exists between the price of a good and the amount supplied.
 - B. suppliers provide more of a good as the price of the resources needed to produce the good rises.
 - C. an inverse relationship exists between the price of a good and the amount purchased by suppliers.
 - D. an inverse relationship exists between the price of a good and the amount that buyers choose to purchase.
53. The price elasticity of demand for a commodity is determined *primarily* by the:
- A. incomes of consumers.
 - B. size of the consumer surplus.
 - C. availability of complementary goods.
 - D. availability of substitutes for the goods.
54. In comparing the short-run and long-run responses of purchases to an unexpected increase in price, responses are typically:
- A. larger in the short run than in the long run.
 - B. smaller in the short run than in the long run.
 - C. approximately the same in the short run as in the long run.
 - D. dependent, with respect to magnitude, on the level of competition in the market.

55. The demand for a good is *least likely* to decrease as the result of a:
- A. fall in consumer income.
 - B. rise in the expected future price of the good.
 - C. fall in the number of consumers in the market.
 - D. rise in the price of a complementary good often used with the original good.
56. The supply of a good is *least likely* to increase as the result of:
- A. favorable weather.
 - B. a fall in the price of a resource used in producing the good.
 - C. an increase in the taxes imposed on the producers of the good.
 - D. a technological change allowing cheaper production of the good.
57. A shift in the demand curve for a good is *least likely* to result from:
- A. increased price for the good.
 - B. increased incomes of buyers.
 - C. increased price of a substitute good.
 - D. decreased price of a complementary good.
58. Which of the following conditions is required for equilibrium in a market?
- A. Producer surplus is minimized.
 - B. No restrictions exist on the movement of a good.
 - C. The quantity demanded must equal the quantity supplied.
 - D. The producer's opportunity cost must equal the market price.
59. Which of the following conditions must be met to achieve economic efficiency?
- A. All activities that produce more benefits than costs for the individuals within an economy are undertaken.
 - B. A large number of sellers exist that supply differentiated products to a market with low barriers to entry.
 - C. A small number of sellers exist that supply products at prices that reflect savings from economies of scale.
 - D. A large number of small companies exist producing an identical product in an industry that has complete freedom of entry and exit.
60. Which of the following factors is *least likely* to provide a valid basis for government action to improve the performance of markets?
- A. Externalities
 - B. Public goods
 - C. Excessive competition among sellers
 - D. Incomplete information for market participants

MARKETS AND INSTRUMENTS: 5 Questions

61. The call feature associated with a corporate bond determines the:
- A. date on which bondholders can request that their funds be repaid.
 - B. terms under which the borrowing company can redeem the bond prior to maturity.
 - C. conditions under which bondholders can request that the company add to its financial reserves.
 - D. requirements for the borrowing company to notify bondholders about material changes in its financial condition.
62. The seniority of a bond refers to the:
- A. time remaining until the bond matures.
 - B. average age of the assets securing the bond.
 - C. time that has passed since the bond was issued.
 - D. priority of the bond's claim on the company's assets.
63. Yankee bonds are fixed-income securities that are issued:
- A. in the US by non-US borrowers, paying interest in US dollars.
 - B. in the US by non-US borrowers, paying interest in a non-dollar currency.
 - C. outside the US by US borrowers, paying interest in US dollars.
 - D. outside the US by US borrowers, paying interest in a non-dollar currency.
64. Futures contracts provide for the:
- A. optional delivery of an asset at a specified future date for a specified payment.
 - B. mandatory delivery of an asset at a specified future date for a specified payment.
 - C. optional delivery of an asset at a specified future date for a payment to be determined at the future date.
 - D. mandatory delivery of an asset at a specified future date for a payment to be determined at the future date.
65. A real estate investment trust provides a means for investing in:
- A. a portfolio of real estate assets.
 - B. the non-US real estate assets of US companies.
 - C. the cash flows generated by rental payments on commercial property.
 - D. a portfolio of shares in companies that develop or own real estate assets.

CFA[®] Candidate Self-Assessment Test

Answers

Financial Statement Analysis: 30 Questions

1. A. Accrual accounting techniques have been developed to apply the matching rule. This rule requires that revenues be assigned to periods when goods are sold or services performed and that expenses be assigned to periods when they produce revenue.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 137.
2. C. Retained earnings is a component of common equity.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 237.
3. C.

Cash	\$100,000
Short-term investments	50,000
Accounts and notes receivable	130,000
<u>Inventory</u>	<u>140,000</u>
Current Assets	\$420,000

Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 236.
4. A. Retained earnings, \$50,000, represents all earnings of the firm (less any losses, dividends or transfers to capital) that were reinvested in the firm since its inception.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 561.
5. A. The difference between net sales and cost of goods sold is gross margin.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 241.
6. D. Under accrual accounting, credit sales as well as cash sales are recognized in net revenue when earned.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 242.
7. D. The length of time a company expects to hold an investment is the determining factor in classifying an asset as short-term or long-term.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 334-337.
8. D. Consistent with the matching rule, the allowance method requires that losses from bad debts be estimated and recorded as an expense in the period when the credit sales occur.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 339-340.
9. B.
$$\begin{aligned}\text{Cost of goods sold} &= \text{Cost of goods available for sale} - \text{Ending inventory} \\ &= \text{Beginning inventory} + \text{Inventory purchases} - \text{Ending inventory} \\ &= \$100,000 + \$250,000 - (\$100,000 - \$20,000) \\ &= \$270,000\end{aligned}$$

Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 379-384.

10. A. Inventory costing methods rely primarily on assumptions about the flow of costs. The cost flow assumed may or may not be the same as the physical flow of goods.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 379.
11. A. With new fixed assets, straight-line depreciation results in lower depreciation than the double-declining-balance method. Lower depreciation leads to higher reported earnings. Given the inflationary economy, using FIFO leads to the inclusion of less expensive inventory items in cost of goods sold, which also leads to higher reported earnings.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 385-387, 470-472.
12. B. The inventory valuation method that results in the lowest net income is the one that results in the highest of cost of goods sold. In a period of rising prices, LIFO results in the highest value of cost of goods sold.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 385-387.
13. D. With LIFO, cost of goods sold will be higher and inventories lower. Therefore, the company will have:
- higher cost of goods sold.
 - lower net income.
 - lower income taxes.
 - lower current assets.
- Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 385-387.
14. D. If cost of goods sold is overstated, operating income will be understated.
Cost of Goods Sold = Cost of Goods Available for Sale – Ending Inventory.
Cost of Goods Sold = Beginning Inventory + Inventory Purchases – Ending Inventory
If ending inventory is understated by \$3,000, COGS will be overstated by \$3,000 and operating income will be understated by \$3,000. If beginning inventory is overstated by \$5,000, COGS will be overstated by \$5,000 and operating income will be understated by \$5,000. The effect of both is to overstate COGS by \$8,000 and understate operating income by \$8,000.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 388-389.
15. C. The term “market” refers to the current replacement cost of inventory, which is the amount that would be paid at present for the same goods.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 390.
16. C. Annual depreciation = (Cost – Residual value)/Estimated useful life
= (\$30,000 – \$5,000)/5
= \$5,000
Carrying value after two years = \$30,000 – (2 × \$5,000) = \$20,000.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 470.
17. D. The cost of repairing equipment damaged during installation would be reported as an operating expense, rather than as part of the capital expenditure.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 466.

18. B. Depreciation is a non-cash expense that represents distributing the costs of assets over their useful lives.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 468-469, 646.
19. B. For the annual interest expense to reflect the effective interest rate, the interest expense each year must include a portion of the discount. This amortization of the discount is the difference between the actual interest payment and the (higher) interest expense for each period.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 517.
20. C. Contributed capital represents investments of stockholders. In contrast, the item “retained earnings” depicts the portion of earnings retained by the company, rather than distributed as dividends.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 561.
21. A. The purchase of treasury stock reduces both the assets (cash) and the stockholders’ equity of a company.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., p. 569.
22. D. Retained earnings are reduced by the amount of dividends paid, reducing stockholders’ equity.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 562-563.
23. B. Cash dividends transfer corporate assets to shareholders and reduce retained earnings.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 605-610.
24. D. According to generally accepted accounting principles, gains and losses from discontinued operations should be reported separately on the income statement.
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 596, 601.
25. B. Cash collections from customers \$260
 Salaries paid –35
 Cash payments to suppliers –85
 Cash payments for interest –12
 Cash flows from operating activities \$128
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 658-661.
26. C. Sale of equipment \$30
 Purchase of land –8
 Purchase of equipment –40
 Cash flows from investing activities –\$18
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 638, 648-651.
27. B. Payments to retire stock –\$32
 Payment of dividends –37
 Cash flows from financing activities –\$69
Reference: Needles and Powers, *Financial Accounting*, 7th ed., pp. 639, 651-653.

28. D. The basic balance sheet equation is $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$
Reference: White, Sondhi, Fried, *Analysis and Use of Financial Statements*, 2nd ed., p. 16.
29. A. Balance sheets show the book value of all assets, liabilities, and stockholders' equity at a point in time.
Reference: White, Sondhi, Fried, *Analysis and Use of Financial Statements*, 2nd ed., p. 69.
30. C. Auditors are only required to verify there are no material errors.
Reference: White, Sondhi, Fried, *Analysis and Use of Financial Statements*, 2nd ed., pp. 24–25.

Economics: 30 Questions

31. C. GDP includes only the output produced, and the income earned, within a country. In the estimation of GDP, the income a country's citizens earn abroad is excluded.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 172–175.
32. D. Gross private domestic investment is the only factor that reflects expenditures.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 172–174.
33. A. GDP is the market value of final goods and services produced; sales of services are included.
Reference, Gwartney, Stroup, and Sobel, *Economics: Private and Public Choice*, 9th ed., p. 169.
34. D. A surplus of a good will create downward pressure on the price, which will in turn induce buyers to purchase more, moving along the demand curve (a change in demand).
Reference, Gwartney, Stroup, and Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 73–74.
35. B. The GDP deflator would be appropriate because it reflects movements in the prices of goods and services purchased by businesses and governments as well as by consumers.
Reference, Gwartney, Stroup, and Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 177–179.
36. B. GDP includes all except household production. The omission of household production leads to the understatement of total output.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 172–174, 180.
37. C. Only the business peak is accurately described.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 193–194.

38. C. Employees who have been temporarily laid off and are waiting to go back to their positions are included in the unemployed category.
Reference, Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 194–198.
39. D. Frictional unemployment counts only the number of qualified and employable workers who are in transition between jobs. This unemployment stems from the constant changes in the demand and supply of specific employers and employees, and the time required for job seekers to conduct job searches.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., p. 199.
40. B. Inflation refers to the movement in the general level of prices of goods and services in an economy.
Reference, Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., p. 205.
41. C. Inflation rate = $[(\text{This year's CPI} - \text{Last year's CPI}) / \text{Last year's CPI}] \times 100$
= $(252 - 240) / 240 \times 100$
= 5.0%.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 205–206.
42. B. Substantial inflation is normally not associated with the economic conditions identified in A, C, and D, but only in B.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., p. 209.
43. B. All are true except “B”: Inflation affects both product prices and resource prices.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., p. 209.
44. D. An increase in the international exchange rate of the nation’s currency will tend to increase imports and decrease exports. The decline in net exports will lower aggregate demand.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 245–247.
45. B. If the supply of resources used to produce output decreases, then the resources will be less abundant and the aggregate supply of products will be reduced.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 251–252.
46. B. Changes in employment levels tend to reinforce, rather than dampen, cyclical changes in economic activity.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 261–262.
47. A. In the classical view, wages and prices would adjust quickly in the presence of imbalances between supply and demand. In contrast, the Keynesian model assumes that wages and prices were inflexible, particularly downward.
Reference, Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 271–272.

48. D. In the Keynesian framework, macroeconomic equilibrium occurs when planned spending and current output are equal, implying consistency between the plans of buyers and producers. Reference, Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 275–277.
49. B. Marginal propensity to consume = Additional consumption/Additional income
 $= \$3,000/\$4,000$
 $= 0.75$
 Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 284–285.
50. C. $M = 1/(1 - MPC)$
 $= 1/(1 - 0.80)$
 $= 1/(0.20)$
 $= 5$
 where M is the expenditure multiplier and MPC is the marginal propensity to consume. An independent increase in investment expenditures of \$10 billion would cause the equilibrium level of aggregate income to rise by $5 \times \$10 \text{ billion} = \50 billion .
 Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 283–285.
51. B. Based on the law of demand, buyers are expected to buy an increased (decreased) amount of a good if the price is decreased (increased).
 Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., p. 57.
52. A. Based on the law of supply, producers are expected to supply an increased (decreased) amount of a good if the price is increased (decreased).
 Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., p. 67.
53. D. A commodity competes in the market with goods that are substitutes. If a substitute good is widely available, a small change in the price of a good will cause buyers to switch to the substitute, reducing the quantity demanded of the good. A large response in quantity demanded to a small change in price indicates a high elasticity.
 Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 60–61.
54. B. With more time to adjust to a price change caused by a shift in supply, buyers will identify more ways to respond to the unfavorable price movement. As a result, the change in quantity demanded will be smaller in the short run.
 Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 79–81.
55. B. If buyers expect a rise in the future price of a good, they will now demand and hoard an increased amount before the rise in price.
 Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., p. 64.
56. C. An increase in taxes imposed on producers is not likely to increase the supply of a good because costs to producers have increased.
 Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 71–72.

57. A. A change in the price of a good causes a movement along a demand curve, not a shift in the whole curve.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 61–65.
58. C. Equilibrium conditions exist when the product price has adjusted to all of the forces of supply and demand. This adjustment has occurred when the market clears at the price where quantity demanded just equals the quantity supplied.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., p. 73.
59. A. Within an economy, efficiency requires that individuals undertake all activities that produce benefits that exceed their costs.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 122–123.
60. C. The absence of competition among sellers, resulting from monopoly power, would provide a basis for government action.
Reference: Gwartney, Stroup, Sobel, *Economics: Private and Public Choice*, 9th ed., pp. 125–134.

Answers to Markets and Instruments Section of Self-Assessment Test

61. B. The call feature describes the terms under which the borrower can redeem bonds prior to the contracted maturity.
Reference: Reilly and Brown, *Investment Analysis and Portfolio Management*, 6th ed., p. 81.
62. D. Seniority describes the relative standing of the claims of different categories of bonds against the assets of a borrower in the event of default or bankruptcy.
Reference: Reilly and Brown, *Investment Analysis and Portfolio Management*, 6th ed., p. 81.
63. A. Yankee bonds are sold in the US by non-US borrowers, with interest payments made in US dollars.
Reference: Reilly and Brown, *Investment Analysis and Portfolio Management*, 6th ed., p. 83.
64. B. In a futures contract, all of the terms, including the delivery date and payment amount, are determined at the time the contract is bought or sold.
Reference: Reilly and Brown, *Investment Analysis and Portfolio Management*, 6th ed., p. 86.
65. A. A real estate investment trust is a vehicle for investing in real estate assets, either equity positions or mortgages.
Reference: Reilly and Brown, *Investment Analysis and Portfolio Management*, 6th ed., p. 88.