



## Exam 2014, Questions, 1

Principles Of Business (University of California, Berkeley)



## Module 1 Exam – Cover Sheet

### Instructions

- This is an exam. Do not talk.
- Your books, notes, and electronic devices must be put completely away, out of sight.
- **Do not open the exam** until you are told to begin.
- Once you leave the exam room, you may not return. No bathroom or other breaks during the exam.
- Turn in your Scantron in the folder for your Discussion Section number.
- Keep the questions when you leave.
- If you do not have a Scantron form/pencil, take your seat, raise your hand and wait with your \$10
- Any contravention of these instructions will lead to your ejection from the exam with zero points
- While you are waiting to begin, enter the following information on your Scantron:

LINE:	INFO TO ENTER:	EXPLANATION:
Name:	LAST, First, Middle	Make sure your family name comes first
Subject:	1234-5678	Your Student ID Number
Test No.:	<b>See question 38</b>	This is your test version (ABCD) and unique ID number (0 to 9999)
Date:	1	This is the module number for this exam
Hour (Period):	101, 102, 103, etc.	This is your Discussion Section number – see below

Section	Day / Time	GSI Name
101	Tu 8-9A	Jonathan Heyne
102	Tu 9-10A	Jonathan Heyne
103	Tu 10-11A	Tia Hansen
104	Tu 11-12P	Yekaterina Barilov
105	Tu 12-1P	Yekaterina Barilov
106	W 8-9A	Federico Merino
107	W 10-11A	Peter Trujillo
108	W 11-12P	Peter Trujillo
109	W 12-1P	Tristan Fitzgerald
110	W 1-2P	Federico Merino
111	Th 8-9A	Tristan Fitzgerald
112	Th 9-10A	Tristan Fitzgerald
113	Th 10-11A	Tia Hansen
114	Th 11-12P	Thomas Garland
115	Th 12-1P	Jeffrey Routh
116	Th 1-2P	Jeffrey Routh
117	Tu 1-2P	Kelly Ling
118	Tu 2-3P	Kelly Ling
119	W 2-3P	Thomas Garland

**UGBA 10 – Principles of Business**  
**MODULE 1 EXAM – Fall 2014 10/3/2014**  
**FINANCE & ACCOUNTING**  
**Instructor: Professor Briginshaw**

1) Jose is a recent college graduate who has been hired for an entry-level professional position in the accounting department of a large corporation. Which of the following terms BEST describes Jose's capacity as an accountant?

- A) public accountant
- B) private accountant
- C) forensic accountant
- D) advisory accountant
- E) management accountant

Answer: B

Reference: Page 222 of custom text. Most private accountants are also management accountants, but not all.

2) A company's owners established a company on January 1, investing \$10,000 total into the stockholders equity of the company. The company then made net income of \$3,500 in the first year. No dividends were paid. Its total liabilities stand at \$7,000 on December 31 of the first year. What is the value of the total assets of this company?

- A) \$500
- B) \$6,500
- C) \$13,500
- D) \$20,500
- E) \$27,500

Answer D

Explanation :  $SE = 10 + 3.5$  (all profits retained as part of equity as no dividends were paid);

$A = L + SE = 7 + 13.5 = 20.5$

Reference: Custom text page 225

3) Who is the President of the European Central Bank?

- a) Mario Draghi
- b) Angela Merkel
- c) Silvio Berlusconi
- d) Jacob Lew

Answer: A

4) Which of the following statements is TRUE?

- A) As common practice, a union representative for the workers at a firm receives information from the firm's financial accounting system.
- B) As common practice, a union representative for the workers at a firm receives information from the firm's managerial accounting system.

- C) As common practice, a union representative for the workers at a firm receives information from both the firm's managerial accounting system and its financial accounting system.
- D) As common practice, a union representative for the workers at a firm receives information from the firm's forensic accounting system.
- E) As common practice, a union representative for the workers at a firm does not receive any information from the firm's accounting system.

Answer: A

Explanation: A) The financial accounting system is concerned with external users, such as unions.

Reference: Custom text page 219 – “A firm’s financial accounting system is concerned with external information users: consumer groups, unions...”

5) Which of the following refers to the financial statement detailing a firm's assets, liabilities, and owners' equity?

- A) income statement
- B) statement of cash flows
- C) balance sheet
- D) expense report
- E) annual budget

Answer: C

Explanation: C) A balance sheet uses the accounting equation to show the current value of a company.

Reference: custom text page 226, first line.

6) Which of the following terms refers to any economic resource that is expected to benefit a firm or individual who owns it?

- A) asset      B) liability      C) equity      D) account      E) deposit

Answer: A

Reference: custom text page 225, first line.

7) Which of the following terms refers to the comprehensive system for collecting, analyzing, and communicating financial information?

- A) bookkeeping      B) accounting      C) controlling      D) auditing      E) budgeting

Answer: B

Reference: custom text page 218

8) According to the standard rule of thumb of asset allocation, as investors near retirement they should have

- A) An increasing proportion of their investments in stocks
- B) A decreasing proportion of their portfolio in stocks
- C) A constant dollar amount of their portfolio in stocks
- D) A constant percentage of their portfolio in stocks

Answer: B

Explanation: Investors should consider investing about their age as a percentage in bonds, so as age increases common stock proportion decreases

Reference: Lecture 11, slide 21

9) A customer has a bond fund which returns 1% before fees, and the fees/charges for the fund are 1.5% of the investment per year. In 2009, the customer invests \$10,000 in the fund. After three years, the customer's funds would be closest to:-

- a) \$9550              b) \$9700              c) \$9850              d) \$10,150

answer: c

Explanation: 0.5% or about \$50 lost per year

10) A person will receive \$132 in 2 years while the prevailing interest rate is 15%. What is the present value of the payment?

- a) \$100              b) \$115              c) \$132              d) \$175

Answer: a

Explanation:  $PV = FV/(1+r)^t = 132/1.15^2 = \$100$

11) According to the "Earnings Game" reading, channel stuffing – as part of manufacturers unethically boosting sales into the retail channel to their customers such as Sears and Walmart - is characterized by all of the following **except**

- a) selling goods to customers who are not ready to buy yet  
b) seller often finances the purchase interest free  
c) seller often offers an extended service contract to the end user  
d) in some cases, seller pays for the cost of storing the inventory until it is sold to the final user  
e) all of the above are features of channel stuffing

Answer: c

Reference: Earnings Game reading page 8, column 2. The key point here is that channel stuffing appeals to the interests of the retailer and not to the customer, as the manufacturer is merely trying to get the retailer to accept unwanted inventory to increase the manufacturer's period end revenues. There is no effort to create "genuine sales" to the end user by methods such as extended service contracts. **NOTE: READING DELETED**

12) "The Everything Boom" reading suggests that the main reason for current high asset prices is:

- a) recovery of the underlying economy  
b) technological progress  
c) loose monetary policy  
d) high returns for ultra-safe assets

Answer: C

Reference: Earnings boom page 2, first full paragraph. The author's view is that the cause of the high asset values is an excess of money supply and low interest rates, also known as a loose monetary policy. . **NOTE: READING DELETED**

13) Which of the following agencies guarantees the safety of all of its members' bank accounts?

- A) Internal Revenue Service
- B) Federal Open Market Committee
- C) Federal Reserve Bank
- D) Federal Deposit Insurance Corporation
- E) Federal Exchange Commission

Answer: D

Reference: Custom text page 269

14) Which of the following is a use of cash on the Capsim finance screen?

- a) Promo budget
- b) Selling unwanted plant and equipment
- c) Retiring Long term Debt
- d) Issuing Stock

Answer : C

Explanation: Promo budget is not on the finance screen. Sales of equipment and issuance of stock are both *sources* of cash

15) What is the price at which the quantity of goods demanded and the quantity of goods supplied are equal?

- A) the going rate
- B) the margin rate
- C) the market price
- D) the optimum price
- E) the cost price

Answer: C

Reference: custom text page 17, lower right hand diagram caption

16) Which economic system emphasizes the private ownership of most factors of production?

- A) Socialism
- B) Communism
- C) Capitalism
- D) Marxism
- E) Federalism

Answer: C

Reference: custom text page 13, 80% down

17) In terms of GDP, how does the US Economy compare?

- a) The US economy is larger than all of the other economies combined and constitutes 80% of World GDP
- b) The US economy is the largest in the world, and is 80% larger than its nearest competitor
- c) The US economy was the largest in the world but is now 2<sup>nd</sup> with 80% of the size of China

d) The US economy is about half the size of the Chinese economy

Answer: B

Reference: Lecture 1, slide 13

18/ Andrews Cheese is a cheese shop. In January, Andrews Cheese finds some excellent cheese called Camembert. They buy \$800 worth, taking delivery and paying in cash in January. In February they start to sell the cheese, and deliver half of the cheese to their favorite customers for a 50% markup (earning revenue of \$600) in February. The customers must pay in 30 days (so they will pay Andrews Cheese in March). What is the Revenue, Income and Cash flow for Andrews Cheese in February?

	Revenue	Income	Cash flow
a)	0	-200	0
b)	600	400	-800
c)	600	200	0
d)	600	200	-200

Answer: c

Explanation: Cost = half x 800 = 400

revenue = 400+(400\*.5) = 600

income = 600-400 = 200

cash flow = there is none

19) Which of the following BEST describes what are called the "open-market operations" of the Federal Reserve System?

- A) the development of new financial opportunities for banks
- B) the minting of new money to disperse into the money market
- C) the control of interest rates among banks
- D) the maintenance of a well-functioning lending system among banks
- E) the buying and selling of securities

Answer: E

Explanation: E) This allows the Fed to ensure an active market.

Reference: custom text page 272

Use the following text to answer the next two questions

### **Where House Prices Shot Up, Rebound Is Slowest**

SEPT. 26, 2014

By FLOYD NORRIS

WHEN an economy is growing rapidly, and the population is increasing, house prices are likely to rise.

Conversely, areas with slow growth are not likely to see house prices increase.

That is generally what has happened in the United States since the summer of 2007, when house prices peaked, as measured by the Federal Housing Finance Agency index. But there are exceptions.

REGION (sorted by change in GDP)	CHANGE IN	
	REAL GDP 2Q 2007 to 4Q 2013	HOME PRICES June 2007 to July 2014
WEST SOUTH CENTRAL	+18.6%	+14.6%
WEST NORTH CENTRAL	+11.8%	+1.6%
PACIFIC incl. California	+7.4%	-14.1%
EAST SOUTH CENTRAL	+5.6%	0.0 (no change)
MIDDLE ATLANTIC	+5.1%	-5.4%
MOUNTAIN	+4.1%	-9.6%
NEW ENGLAND	+3.4%	-4.4%
SOUTH ATLANTIC incl. Florida	+2.1%	-11.1%
EAST NORTH CENTRAL incl. Michigan	+2.0%	-4.6%

20) All of the following are true about GDP **except**

- a) GDP considers only domestic factors of production
- b) GDP is a good measure of aggregate output
- c) GDP and GNP will usually only differ by less than 1%
- d) GDP is dependent on the volume of common stocks traded on a nation's stock exchanges

Answer: D

Reference: custom text page 21

21) In regard to the above table, all of the following are true **except**

- a) In most regions, real GDP has grown while home prices have fallen
- b) In the Pacific region, economic growth has been positive but home price growth has not
- c) In the South Atlantic Region, both economic growth and home price growth have been positive
- d) In the East North Central region, home prices have fallen and economic growth has been low compared to the other regions

Answer: C

22) When thinking about exchange rates, an expensive dollar relative to the Euro is **best** for

- a) European tourists visiting the USA
- b) US exporters selling into the Euro Zone
- c) Euro zone companies seeking to sell imports into the USA
- d) Japanese tourists visiting the United States

Answer: C— a given number of dollars buys more in euros

Reference: custom text page 278



23) David is saving \$25 a week toward getting a new truck. Which function of money does this illustrate?

- A) stabilization of value
- B) foundation of banking
- C) medium of exchange
- D) store of value
- E) measure of worth

Answer: D

Explanation: D) In the form of currency, money can be used for future purchases and thus "stores" value.

Reference: Custom text page 261 – “money can be used for future purchases”

### Contribution Margin

24) Mick's Pizza pays \$1200 fixed rent per month and each pizza costs \$2 in ingredients and hourly paid labor. Pizzas sell for \$5 per pizza - what is the break even number of pizzas for Mick's pizza?

- a) 400 pizzas
- b) 267 pizzas
- c) 667 pizzas
- d) 500 pizzas

Answer: A

25) Mick's Pizza pays \$1200 fixed rent per month and each pizza costs \$2 in ingredients and hourly paid labor. If Mick's sells 500 pizzas, what is the total contribution margin and what is the profit (ignore taxes)?

	Contribution margin	Profit
a)	\$1200	\$0
b)	\$1500	\$700
c)	\$1000	\$200
d)	\$1500	\$300

Answer: D

Financial Statement and ratio analysis: Use the following information on Peters Incorporated to answer the next two questions

Average stockholders' equity	\$10,000	Net income	\$ 1,500
Average total assets	\$15,000	Net sales	\$30,000
Current assets	\$10,000	Total liabilities	\$5,000
Current liabilities	\$2,000		

26) What is the Net profit margin for Peters?

- a) 2
- b) 15%
- c) 5%
- d) 5

Answer: c

Explanation: Net profit margin = net income/sales = 1500/30000 = 5%

Reference: HBS reading page 2

27) What is the Current ratio for Peters?

- a) 2
- b) 15%
- c) 5%
- d) 5

Answer: d

Explanation: Current ratio = Current assets/current liabilities

Reference: Custom text page 233 and HBS reading page 5

28) Which of the following statements is NOT true about dividend payments?

- A) Many companies distribute between 30 and 70 percent of their profits to shareholders.
- B) Some firms, especially fast-growing companies, do not pay dividends.
- C) Many fast-growing companies use cash earnings for expanding the company so that future earnings can grow even faster.
- D) During unprofitable years, companies are still required by law to pay dividends to their stockholders.
- E) Dividend payments are made to stockholders on a per-share basis.

Answer: D

Explanation: D) Companies are not compelled by law to pay dividends; stockholders receive dividends only if the company makes money.

29) Twenty-six-year-old Lisa Lamont became an investor one day after a friend explained that there was a much better way to make her money work for her than by letting it sit in a savings account earning a very low rate of interest. Lisa decided to withdraw \$10,000 from her savings account and invest it in stocks. She wanted to invest it in such a way as to minimize her risk. Which one of the following strategies makes the MOST sense for a new investor like Lisa?

- A) Invest all \$10,000 in a small fast-growing computer company.
- B) Invest \$5,000 in a gold mining company and \$5,000 in a silver mine.
- C) Invest the \$10,000 in four different home builders.
- D) Invest \$10,000 in ten different oil companies.
- E) Invest \$10,000 in a large-cap mutual fund.

Answer: E

Explanation: E) As a person investing in stocks for the first time, the possibility of losing money can be scary. For peace of mind, the safest way to go is to choose maximum diversification. A

large-cap mutual fund offers this diversification, and large-cap companies offer potential capital gains with less risk than small-cap companies.

30) What is the term for the proportion of funds invested in each of several investment alternatives or asset classes?

- A) spreading
- B) shorting
- C) margin buying
- D) asset allocation
- E) diversification

Answer: D

Explanation: D) For example, you may decide to allocate \$10,000 to common stocks, \$5,000 to a money market mutual fund, and \$2,500 to a U.S. Treasury bond fund.

31) "I am a chemist with the nation's largest chemical company. We have secretly developed a cure for three of the world's most serious epidemics. Before this news breaks out, I'm going to buy as many shares of stock in my company as I can get my hands on. Then I'll sit back and watch the stock price head for the sky." What is the person making this statement about to engage in?

- A) selling shares of stock
- B) insider trading
- C) blue-sky trading
- D) open-market operations
- E) investment banking

Answer: B

Explanation: B) Insider trading is an illegal activity that occurs when individuals use special knowledge about a firm for profit or gain.

32) Tonio has some stocks and is carefully watching the stock market. Which of the following should he pay attention to in order to find out the performance of the **largest** companies?

- A) Standard & Poor's 500
- B) the NYSE index
- C) Dow Jones Industrial Average (Dow 30)
- D) Moody's Stock List
- E) the NASDAQ

Answer: C

Explanation: C) The Dow includes only 30 of the thousands of companies on the market, but these companies are the largest and most important

33) A company holding a large proportion of cash will most likely have which of the following characteristics

- a) It will have little money available for investment
- b) It will have a higher asset turnover than a similar company with no cash

- c) The cash will tend to increase the company's return on assets
- d) The cash will tend to decrease the company's return on assets

Answer: D. Cash has low returns compared to operating assets, as shown by the example of Google.

34) Which of the following is an example of a psychological bias known to be a problem for investors

- a) profit affection
- b) market fluctuation effect
- c) loss aversion
- d) lack of liquidity

Answer: c

Read the following information about sub prime loans and then answer the next two questions

Subprime loans have higher interest rates than conventional loans. Subprime loans are designed for borrowers with low credit scores who would not qualify for conventional loans. The borrower pays a higher rate to compensate the lender for the greater risk of a default. Subprime loans typically have adjustable rates, meaning that the interest rate can change over the life of the loan. Borrowers who take out adjustable subprime loans usually try to keep the rate as low as possible at the start of the loan, even when doing so would lead to higher payments over the entire life of the loan. After a large number of people defaulted on their subprime loans, research revealed that the majority of people who took out subprime loans could have qualified for conventional loans.

35) The statements above most strongly suggest that if all subprime loan borrowers had taken out the loan that was most appropriate for their needs, then what would have been the outcome?

- A) None of them would have taken out an adjustable loan.
- B) None of them would have taken out a subprime loan.
- C) Most of them would have paid less in interest.
- D) Most of them would have taken out a conventional loan to cover any expenses not covered by a subprime loan.
- E) Most of them would have paid money at the start of the loan in order to get a reduced interest rate over the life of the loan.

Answer: C

Explanation: C) Subprime loans cost more than conventional loans, but most people who took out subprime loans could have gotten conventional loans. So if everyone had gotten the most appropriate loan, most of the people who took out subprime loans would have gotten lower rates and therefore paid less in interest, Choice C. Choices A and B go too far. There might have been some people who were better off with these loans. Choices D and E are possible events, but there's no evidence that either would have happened most of the time.

36) Taking out a subprime loan to buy a house is MOST likely to be a reasonable financial decision when which of the following is TRUE?

- A) Qualifying for a conventional loan is impossible.
- B) Owning a home is an important life goal for the borrower.
- C) Adjustable rates are likely to be higher than fixed rates.
- D) The borrower reasonably expects to have greater financial means in the near future.
- E) The previous owner of the house took out a subprime loan.

Answer: D

Explanation: D) Can a subprime loan ever be a good idea? Sure. If you need a subprime loan because you can't qualify for a conventional one, then you're probably a high-risk buyer. But if you're about to come into more money in the near future, Choice D, then it might be worth getting a bad rate now if you reasonably think you'll be able to afford it later. Choice A: Not being able to get a regular loan doesn't mean that a subprime loan is a good idea. Maybe you really can't afford it. Choice B: Wanting a house desperately isn't a reason to take out a high-interest loan. Choices C and E tell us nothing about the buyer and his or her ability to pay.

The key intuition is that a subprime loan is a bad idea for two main reasons – firstly, it is aimed at people with poor credit, who intrinsically have less chance of being able to genuinely “afford” a house. Secondly, the high costs of subprime further push marginal borrowers into default. Therefore, only if you *know something positive* about your own circumstances that is not known to the lender (i.e. that they will quickly improve, answering point 1 above), should you take on the loan, and then only for a short time, to refi when your circumstances *do* improve (answering point 2).

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37. I have carefully checked my Scantron. My Section number is correctly shown and I have checked that my name is written in the Registrar's form, last name first.

- a. Yes
- b. No

38. This is version “A”: fill in the “A” bubble for this question and write the letter and unique exam identifier “A1234” in the “TEST NO.” box of your Scantron.

**IMPORTANT NOTE: IN THE EVENT YOU DO NOT WRITE YOUR UNIQUE IDENTIFIER (A1234) ON THE SCANTRON, IF YOUR IDENTIFIER DOES NOT MATCH THAT SHOWN ABOVE OR IF IT HAS BEEN USED BY ANOTHER STUDENT, YOU WILL AUTOMATICALLY SCORE ZERO ON THIS TEST.**

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