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QUESTION 1

A period during which real GDP is rising and unemployment is falling is called a(n):

- A. Recession.
- B. Peak.
- C. Expansion.
- D. Trough.

Correct Answer: A

Choice "c" is correct. During an expansion, real GDP is rising and unemployment is falling.

Choice "a" is incorrect. A recession is when real GDP is falling NOT rising.

Choice "b" is incorrect. A peak is the highest point of economic activity. It is the point where real GDP is at its highest level in the cycle and unemployment is at its lowest level in the cycle. Choice "d" is incorrect. A trough is the lowest level of economic activity. It is the point where real GDP is at its lowest level in the cycle and unemployment is at its highest level in the cycle.

QUESTION 2

An increase in government spending will tend to cause:

- A. Real GDP to fall and unemployment to rise.
- B. Real GDP to rise and unemployment to fall.
- C. Real GDP to rise and unemployment to rise.
- D. Real GDP to fall and unemployment to fall.

Correct Answer: B

Choice "b" is correct. An increase in government spending causes an increase in aggregate demand (i.e., causes the aggregate demand curve to shift right). As a result, an increase in government spending causes real GDP to rise and unemployment to fall.

Choice "a" is incorrect. Real GDP will rise, not fall.

Choice "c" is incorrect. Unemployment will fall, not rise.

Choice "d" is incorrect. Real GDP will rise, not fall.



QUESTION 3

A company uses the following formula in determining its optimal level of cash.

$$C^* = \sqrt{\frac{2bT}{i}}$$

Where: b = Fixed cost per transaction i = Interest rate on marketable securities T = Total demand for cash over a period of time

This formula is a modification of the Economic Order Quantity (EOQ) formula used for inventory management. Assume that the fixed cost of selling marketable securities is \$10 per transaction, and the interest rate on marketable securities is 6 percent per year. The company estimates that it will make cash payments of \$12,000 over a one-month period. What is the average cash balance (rounded to the nearest dollar)?

- A. \$1,000
- B. \$2,000
- C. \$3,464
- D. \$6,928

Correct Answer: C

Choice "c" is correct. Like the EOQ, this formula represents the amount of cash brought in by the sale of marketable securities. Also like the EOQ, this cash goes to zero (or the safety level) over time. The average cash (like the average inventory) is one half of the amount collected. Remember also to convert the interest rate to a per month figure of 0.5%

$$\begin{aligned}C^* &= (2bT/i)^{1/2} \\C^* &= [2(10)12,000/.005]^{1/2} \\C^* &= [240,000/.005]^{1/2} \\C^* &= \$6,928 \\ \text{Average cash} &= \$6,928/2 = \$3,464\end{aligned}$$

Choices "a", "b", and "d" are incorrect, per above.

QUESTION 4

Unless there is an agreement to the contrary, the voting power of members in a limited liability company is determined by:

- A. Each member's salary.
- B. Each member's share of profits.



- C. When the member was admitted to the company.
- D. Each member's capital contribution.

Correct Answer: D

Choice "d" is correct.

Rule: Absent an agreement otherwise, all members generally participate in management, and their voting strength is determined in proportion to ownership interest. This is calculated by comparing each member's capital contribution to that of the other members.

Choices "a", "b", and "c" are incorrect, per the above rule.

QUESTION 5

Which one of the following factors might cause a firm to increase the debt in its financial structure?

- A. An increase in the corporate income tax rate.
- B. Increased economic uncertainty.
- C. An increase in the price/earnings ratio.
- D. A decrease in the times interest earned ratio.

Correct Answer: A

Choice "a" is correct. An increase in the corporate income tax rate might cause a firm to increase the debt in its financial structure because interest is tax deductible, while dividends are paid after-tax. Choice "b" is incorrect. Increased economic uncertainty would cause a firm to decrease debt (and interest cost). Choice "c" is incorrect. An increase in the price/earnings ratio would encourage the issuance of equity rather than debt. Choice "d" is incorrect. A decrease in the times interest earned ratio indicates that earnings have declined compared with interest, and that more debt would be unwise (and more difficult to negotiate).

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