DECA Personal Financial Literacy (PFL) Practice Exam (Sample)

Study Guide

Everything you need from our exam experts!

Questions

1. **When is the ideal time for an individual to start contributing to a retirement plan?**
   - **A. As young as possible**
   - **B. When they have disposable income**
   - **C. After they purchase a home**
   - **D. At age 30**

2. **Which of the following is an example of a long-term debt?**
   - **A. A student loan**
   - **B. A credit card balance**
   - **C. A car lease**
   - **D. A utility bill**

3. **What is the likely effect on car insurance cost if a driver receives several traffic tickets?**
   - **A. Decrease**
   - **B. No change**
   - **C. Increase**
   - **D. Cancelation**

4. **Which of the following describes what happens during a depression?**
   - **A. Economic growth is stable**
   - **B. Unemployment is extremely high**
   - **C. Inflation rates are low**
   - **D. The stock market is booming**

5. **What type of corporation sells shares of ownership through a stock exchange?**
   - **A. Private corporation**
   - **B. Public corporation**
   - **C. Non-profit organization**
   - **D. Sole proprietorship**

6. What is a computer scam that tricks consumers into revealing personal information called?

A. Identity theft

B. Phishing

C. Spam filtering

D. Data mining

7. What does the term "liquidity" refer to in finance?

A. The ease of converting an asset into cash

B. The potential for an asset to appreciate in value

C. The rate of return on an investment

D. The tax implications of selling an asset

8. What must a person do to receive money for damages from a car accident?

A. Make a payment

B. File a claim with his insurance company

C. Request a refund

D. Cancel the policy

9. Why might a lender deny a loan application?

A. Employment status

B. Credit history

C. Loan amount requested

D. Income level

10. A person decided to have six months of income in an emergency savings account. Is this a good decision?

A. No, it is too much cash to have on hand

B. Yes, because the money can be used if he loses his job

C. No, it prevents investing opportunities

D. Yes, but only if it earns interest

Answers

1. A
2. A
3. C
4. B
5. B
6. B
7. A
8. B
9. B
10. B

Explanations

1. **When is the ideal time for an individual to start contributing to a retirement plan?**

   A. As young as possible

   B. When they have disposable income

   C. After they purchase a home

   D. At age 30

Starting to contribute to a retirement plan as early as possible is beneficial for several reasons. One of the key advantages is the power of compound interest, where the money invested can grow exponentially over time due to earning interest on both the initial investment and the accumulated interest. The earlier an individual starts saving, the longer the investment has to grow, leading to a significantly larger nest egg by the time they reach retirement age. Additionally, starting early allows individuals to take more investment risks, which can lead to higher returns over time. Young savers can afford to weather market fluctuations, as they have more time to recover from any downturns. Early contributions also mean that even small amounts set aside can accumulate into a substantial retirement fund due to the long investment horizon. Furthermore, contributing to a retirement plan early can help establish good financial habits, making saving a priority and ensuring that individuals are better prepared for their future financial needs.

2. **Which of the following is an example of a long-term debt?**

   A. A student loan

   B. A credit card balance

   C. A car lease

   D. A utility bill

A student loan is an example of long-term debt because it is typically structured with a repayment plan that spans several years, often ranging from 10 to 25 years depending on the amount borrowed and the terms of the loan. This type of debt is usually taken out to finance education expenses and is paid back in installments over time, making it a long-term financial commitment. In contrast, other options represent different categories of debt. A credit card balance is often considered revolving debt due to its flexible repayment terms and high interest rates. A car lease is considered a type of short-term obligation, where the vehicle is returned at the end of the lease period, typically within a few years. A utility bill is a recurring expense that is paid monthly and does not accumulate into a long-term debt. Therefore, a student loan stands out as it exemplifies an obligation that is commonly sustained over a prolonged duration.

3. What is the likely effect on car insurance cost if a driver receives several traffic tickets?

A. Decrease

B. No change

C. Increase

D. Cancelation

When a driver receives several traffic tickets, the likely effect on car insurance cost is an increase. Insurance companies evaluate a driver's risk profile based on their driving behavior, including any traffic violations. Multiple tickets typically indicate a pattern of risky driving behavior, which can be viewed as a higher likelihood of future accidents or claims. As a result, insurers may raise premiums to offset the increased risk associated with insuring that individual. This increased cost can be due to the potential for more claims being filed as a result of unsafe driving. Additionally, some insurers may state that drivers with a poor traffic record are more likely to be in an accident, thus justifying the increase in their insurance rates. The other options do not reflect the typical industry response to traffic violations. A decrease in rates would be unlikely since insurers reward safe driving, not risky behavior. No change in cost would also be uncommon, as most insurers adjust premiums based on driving history. Cancelation of the policy may occur in severe cases of habitual offenses, but it's not the initial or most frequent response, which is to increase premiums.

4. Which of the following describes what happens during a depression?

A. Economic growth is stable

B. Unemployment is extremely high

C. Inflation rates are low

D. The stock market is booming

During a depression, one of the most significant characteristics is extremely high unemployment. Economic depressions are severe downturns in economic activity that last for an extended period. During these times, businesses may close or operate at reduced capacity, leading to widespread job losses. High unemployment is a key indicator of a depression, as many people find themselves unable to secure jobs, resulting in a significant rise in the unemployment rate. This situation contributes to decreased consumer spending, further exacerbating the economic downturn. In contrast, stable economic growth would indicate a healthy economy, which is not the case during a depression. Low inflation rates may be present in some contexts during a depression, though they can also lead to deflation, where prices drop due to decreased demand. A booming stock market generally reflects positive economic sentiment, which stands in stark contrast to the reality of a depression, characterized by investor pessimism and falling stock prices.

5. What type of corporation sells shares of ownership through a stock exchange?

A. Private corporation

B. Public corporation

C. Non-profit organization

D. Sole proprietorship

A public corporation sells shares of ownership through a stock exchange, allowing the general public to buy and sell its stock. This type of corporation is characterized by its ability to raise capital by selling shares to investors, which can lead to increased financial resources for expansion, research, and operational needs. Public corporations are subject to regulatory requirements imposed by government agencies, which mandate transparency in reporting financial performance and other corporate activities. This oversight is designed to protect investors by ensuring they have access to necessary information for making informed investment decisions. In contrast, private corporations do not have their shares traded on public exchanges and typically have a more limited number of shareholders, which can include family, friends, or private investors. Non-profit organizations focus on social, educational, or charitable goals rather than profit generation, and sole proprietorships are owned and operated by a single individual without share issuance or stock exchange involvement.

6. What is a computer scam that tricks consumers into revealing personal information called?

A. Identity theft

B. Phishing

C. Spam filtering

D. Data mining

The term used to describe a computer scam that tricks consumers into revealing personal information is phishing. Phishing typically involves fraudulent online communications, often appearing to come from a reputable source, such as a bank or an online service. The scam can take various forms, such as emails, messages, or websites designed to mimic legitimate ones, enticing individuals to enter sensitive information like passwords, credit card numbers, or social security numbers. Consumers may receive enticing promises, urgent warnings, or requests for verification that compel them to act quickly and disclose their personal information without verifying the authenticity of the source. This tactic relies heavily on psychological manipulation and a sense of urgency, making individuals more susceptible to sharing sensitive data. Understanding phishing is crucial in personal financial literacy since it can lead to dire consequences like identity theft or financial loss. Recognizing the signs of such scams can empower consumers to protect their information effectively.

7. What does the term "liquidity" refer to in finance?

A. The ease of converting an asset into cash

B. The potential for an asset to appreciate in value

C. The rate of return on an investment

D. The tax implications of selling an asset

Liquidity in finance specifically refers to the ease with which an asset can be converted into cash without significantly affecting its value. Highly liquid assets, such as cash itself or stocks, can be quickly sold or exchanged for cash, making them valuable for meeting immediate financial needs or covering expenses. This contrasts with illiquid assets, such as real estate or collectibles, which may take longer to sell and may not sell quickly at market value. Understanding liquidity is crucial for financial planning and management, as it impacts one's ability to access funds in times of need. For example, if someone holds a significant amount of their wealth in illiquid assets, they may face challenges in times requiring quick cash availability. The other options pertain to different financial concepts: appreciation relates to an asset's potential value increase, rate of return describes the earnings generated from an investment, and tax implications focus on the financial consequences associated with selling.

8. What must a person do to receive money for damages from a car accident?

A. Make a payment

B. File a claim with his insurance company

C. Request a refund

D. Cancel the policy

To receive money for damages from a car accident, a person must file a claim with their insurance company. This process involves formally notifying the insurance provider about the accident and providing necessary details, such as the police report, photos of the damage, and any medical records if there are injuries. The insurance company will then assess the claim, determine coverage, and decide how much compensation is warranted based on the specifics of the policy and the incident. Making a payment does not directly relate to receiving damages; instead, it typically refers to paying premiums or deductibles. Requesting a refund is not applicable in this context, as it suggests returning something for monetary compensation unrelated to damages from an accident. Canceling a policy could lead to losing coverage entirely, thus making it impossible to claim any damages associated with the accident. Filing a claim is crucial for initiating the process and ensuring that the person receives the appropriate amount to cover their losses.

9. Why might a lender deny a loan application?

A. Employment status

B. Credit history

C. Loan amount requested

D. Income level

A lender might deny a loan application due to credit history because this is a crucial indicator of a borrower's reliability in repaying debt. Lenders review a borrower's credit history to assess their past behaviors regarding credit management, including on-time payments, outstanding debts, and their overall credit score. A poor credit history can signal to the lender that the borrower may pose a higher risk, indicating that there could be a likelihood of defaulting on the loan. While employment status, loan amount requested, and income level are also important factors in the lending decision, they are often evaluated in conjunction with credit history. For instance, even if a borrower has a stable job, a high loan amount requested, or sufficient income, a poor credit history can overshadow these positives. Lenders rely heavily on credit history because it encapsulates a borrower's financial behavior over time, making it one of the primary reasons for potential loan denial.

10. A person decided to have six months of income in an emergency savings account. Is this a good decision?

A. No, it is too much cash to have on hand

B. Yes, because the money can be used if he loses his job

C. No, it prevents investing opportunities

D. Yes, but only if it earns interest

Maintaining six months of income in an emergency savings account is considered a prudent financial decision. This strategy provides a financial safety net that can be crucial in times of unexpected hardship, such as job loss or medical emergencies. The primary purpose of an emergency fund is to cover essential expenses during periods of unemployment or financial instability. By having this cash readily available, the individual can manage their living expenses without resorting to high-interest debt or dipping into long-term savings and investments. Furthermore, many financial experts recommend saving three to six months' worth of expenses to ensure that individuals can sustain themselves during emergencies, making this choice aligned with best practices in personal financial management. Having sufficient liquid assets available allows for peace of mind and can prevent individuals from making hasty financial decisions in times of crisis.