

TEACHING

*CSET-Agriculture
CSET California Subject Examinations for Teachers*



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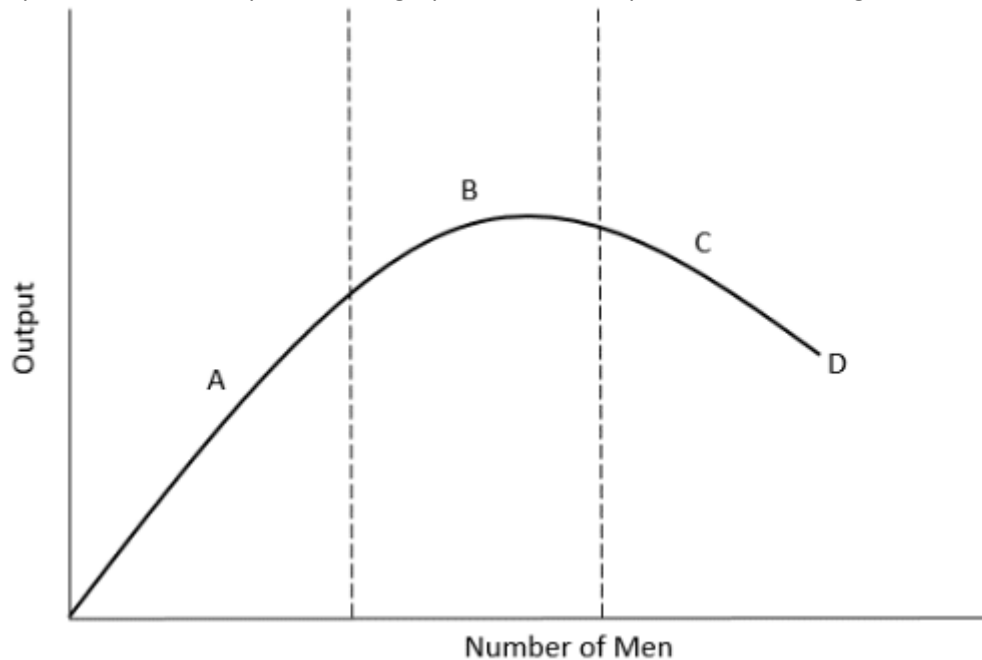
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Question: 1

The law of diminishing returns is a concept in economics used to describe the effects of output with input factors. Which point in the graph indicates the point of diminishing returns?



- A. A
- B. B
- C. C
- D. D

Answer: B

Explanation:

This graph represents the law of diminishing returns. The law of diminishing returns states that if one factor of production (e.g., number of workers) is increased, while other factors (e.g., machines and workspace) are held constant, the output per unit of the variable factor will eventually diminish. Although the productivity of the workforce decreases as output increases, diminishing returns do not mean negative returns until (in this example) the number of workers exceeds the available machines or workspace. In this graph, point A represents the point of increasing product output whereas point C represents the amount of decreasing output. The point just before the dramatic decrease is the point of diminishing returns, shown as point B.

Question: 2

A cotton mill owner wants to know his equity in the business. According to his balance sheet for the previous year, the warehouse premises are valued at \$1 million, the factory equipment is valued at \$1million, and inventory is valued at \$800,000. Debtors owe the business \$400,000. The balance sheet also indicates that he owes the bank \$500,000, creditors \$800,000, and the wages and salaries stand at \$800,000. Calculate his owner's equity.

- A. \$1.1 million
- B. \$2.7 million
- C. —\$1.6 million
- D. -\$800,000

Answer: A

Explanation:

The equation to calculate owner's equity is: owner's equity = assets — liabilities. In this example, the assets would be the warehouse premises, the factory equipment, the inventory, and debt owed to the mill. Total these amounts to calculate \$3.2 million in assets. The liabilities include money owed to the bank and creditors as well as wages and salaries. Total these amounts to calculate \$2.1 million in liabilities. To find owner's equity, plug the numbers into the equation: \$3.2 million — \$2.1 million = \$1.1 million. This means the cotton mill business is currently worth \$1.1 million.

Question: 3

Futures contracts are mainly used by hedgers, speculators, and arbitrators and play a pivotal role in the market of agricultural commodities. Which statement is incorrect?

- A. Hedging is a means to control or eliminate risk and is used by those that are averse to taking risks.
- B. Speculation depends on risk in the hope of making good returns and is used by those who are not afraid to take risk to seek a larger profit.
- C. Speculation is used to minimize or eliminate the probability of substantial loss of profits due to movements in the price of the underlying asset.
- D. Arbitrage involves the simultaneous buying and selling of an asset to profit from small differences in price.

Answer: C

Explanation:

As each market for the same stock moves, market inefficiencies, pricing mismatches, and even exchange rates can affect the prices of commodities temporarily. Hedging is used to minimize or eliminate the probability of profit loss by minimizing the risk. Speculators use risk to try to make larger profits. Arbitrage is used to both increase profits and reduce risk. Arbitrageurs will often purchase stock from one location (e.g., the New York Stock Exchange) and simultaneously sell it at another location (e.g., the London Stock Exchange) to increase profits.

Question: 4

A business owner is interested in expanding the product line that her business sells. She wants to make sure that her business has the funds to expand the product line. Which calculation would be the most useful for her?

- A. Enterprise budget
- B. Free cash flow
- C. Capital expenditures
- D. Net income

Answer: B

Explanation:

Free cash flow calculates how much cash a business generates after accounting for capital expenditures such as buildings or equipment. This cash can be used for expansion, dividends, reducing debt, or other purposes. To calculate free cash flow, the following equation is used: $\text{free cash flow} = \text{net income} + \text{non-cash expenses} - \text{increase in working capital} - \text{capital expenditures}$. Calculating free cash flow requires multiple steps but is one of the most useful calculations that a business owner can make to determine the financial health of a business. An enterprise budget is an estimate of the costs and returns to produce a product. Although this would be helpful to her, she needs to determine if the business can afford to expand first. Net income explains how much the business sold but does not take into account any debts and therefore can be misleading. Capital expenditure calculates the money a business spends on purchasing or maintaining a fixed asset, such as land or the business building.

Question: 5

Risk is involved with any business and can affect agribusinesses even more. A crop farmer wants to reduce the risk in his business. Which is NOT a way he can reduce risk?

- A. Try different production practices.
- B. Invest in crop insurance.
- C. Incorporate new technology into production.
- D. Eliminate contract production to increase flexibility.

Answer: D

Explanation:

There are many risks that affect agribusinesses. These risks can be categorized into five general areas: production, marketing, financial, legal, and human resources. One of the best ways to reduce risk is to become more flexible as a producer. A row cropper may be interested in multicropping practices to offer more commodities. Crop insurance is a way to manage risk that is created by weather conditions. New technology is also a way to decrease risk (e.g., a chemical pesticide that can kill crop-destroying pests). Contract production is a way to decrease risk as well. Contracts provide producers with a set price and a guarantee to purchase. Eliminating contracts can increase risk. Producers may not sell for as high of a price and may not sell all of the produced

good.

Question: 6

A first-year cattle farmer is completing an enterprise budget. He sold 80 cows for a total of \$60,000. He spent \$15,000 on feed, pasture management, and veterinary expenses. He spent an additional \$20,000 on machinery repair. During this first year, he paid off his \$30,000 farm loan that was used to purchase cattle. He also paid \$25,000 on machinery and land loans and insurance. He suffered a \$5,000 equipment depreciation fee. Calculate his return above total operating costs.

- A. \$25,000
- B. -\$60,000
- C. -\$35,000
- D. \$55,000

Answer: C

Explanation:

An enterprise budget is broken down into production, operating costs, and fixed costs. To calculate the return above total operating costs, the following equation can be used: return above total operating costs = production - total costs. The total costs can be calculated by adding the operating costs with the fixed costs. In this example, the operating costs include the feed, pasture management, veterinary services, and machinery repair. Fixed costs include the farm loan, machinery and land loans, insurance, and depreciation. These values can then be plugged into the equation: returns above total operating costs = \$60,000 — (\$35,000 + \$60,000).

Question: 7

There are two types of accounting that can be used: single-entry and double-entry methods. Which is an example of an incorrect entry using the double-entry method?

- A. Sales revenue of \$500 would be entered into the balance sheet account called "cash" and into the income statement sheet called "revenue."
- B. A \$1,000 computer purchase would be a \$1,000 debit to decrease your income statement "technology" expense account and a \$1,000 credit to increase your balance sheet "cash" account.
- C. When a business borrows money from the bank, the assets will increase by the loan amount, and the liabilities will also increase by the loan amount.
- D. Goods purchased for resale will increase the assets and decrease the "cash" balance sheet.

Answer: B

Explanation:

In this example, the computer purchase should be entered as a \$1,000 debit to increase the income statement "technology" expense account and decrease the "cash" account. The double-entry accounting method requires a chart of accounts, which consists of all of the balance sheet and income statement accounts in which accountants make entries. As a company's business grows, the

likelihood of clerical errors increases. Although double-entry accounting does not prevent errors entirely, it limits the effect any errors have on the overall accounts. The double-entry accounting method is a way to double-check that accounting entries are accurate.

Question: 8

Balance sheets are useful tools for businesses. The balance sheet is one of the most basic fundamentals of business accounting. Which of the following statements is not true about balance sheets?

- A. The balance sheet equation is: net income = revenues — expenses.
- B. The balance sheet equation shows what a company owns, what a company owes, and what stake the owners have in the business.
- C. Claims on the company assets are separated into two categories: liabilities and equity.
- D. Assets are the resources that the company has to use in the future such as cash, accounts receivable, and fixed assets.

Answer: A

Explanation:

The balance sheet equation is: assets = liabilities + equity. The equation net income = revenues - expenses is the equation used to calculate net income. The balance sheet equation is also often called the accounting equation. The balance sheet displays the company's total assets, and how these assets are financed, through either debt or equity. It can also be referred to as a statement of net worth or a statement of financial position.

Question: 9

Large businesses and corporations often use stocks and shareholders to limit liability and increase worth. Which item is NOT correctly defined?

- A. A stock is a unit into which the capital worth of a corporation has been divided.
- B. A dividend is money distributed to a stockholder as his or her share of the company's profits.
- C. A resource is an item that controls or directs a business operation.
- D. Capital is a collection of valued resources made by people and used for production.

Answer: C

Explanation:

A resource is wealth or an asset. Regulatory items are items that control or direct a business operation. An agribusiness manager must be familiar with the options that are available to managing wealth and assets of a company, Agribusiness managers must also be aware of the different types of business management and how resources, stocks, and shareholders affect the management. Businesses can be sole proprietorships, individuals, joint ventures, or corporations. Each business type has different involvement and liabilities associated with it.

Question: 10

Businesses have both fixed and variable costs. An example of a fixed cost would be _____ whereas an example of a variable cost would be _____.

- A. Raw materials; rent
- B. Labor; shipping
- C. Advertising; depreciation
- D. Insurance; commission

Answer: D

Explanation:

Sales commissions are dependent on sales being made, making it a straightforward example of a variable cost. Fixed costs are costs that are independent of output and are fairly constant. Examples of fixed costs include rent, advertising, depreciation, insurances, taxes, and so on. Variable costs are dependent on production output and can change considerably over time. Examples of variable costs include raw materials, labor wages, shipping costs, and sales commissions.

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