SMART WAYS TO MANAGE YOUR FINANCES

Class 09 - Social Science (Understanding Society)

Time Allowed: 1 hour and 28 minutes **Maximum Marks: 162**

1. What is the primary factor that causes compound interest to result in a larger total amount compared to simple interest over the same period? **[1]**

   a) A shorter investment period for compound interest.

   b) The calculation of interest on previously earned interest.

   c) The absence of any fees for compound interest accounts.

   d) A lower interest rate for compound interest.

2. Which intrinsic characteristic is typically associated with investment options that project higher potential gains? **[1]**

   a) Elevated levels of associated financial risk.

   b) Greater predictability of outcomes and lower market exposure.

   c) Lower regulatory oversight and increased accessibility.

   d) Reduced susceptibility to changes in economic conditions.

3. What is the main benefit of investing in a Mutual Fund? **[1]**

   a) Ability to buy and sell instantly on a stock exchange like individual shares

   b) Guaranteed high returns with no risk

   c) Direct control over individual company shares

   d) Diversification and professional management of investments

4. What is the definition of 'saving' in personal financial management? **[1]**

   a) Reducing overall income through extensive charitable contributions annually.

   b) The process of committing capital to ventures with expected future returns.

   c) Setting aside a portion of current earnings for subsequent future utilization.

   d) The act of utilizing funds for immediate, non-essential consumption.

5. Which of the following elements is considered part of an individual's income? **[1]**

   a) Financial gifts received from relatives or earnings from part-time work.

   b) Funds allocated for future investment in volatile market assets.

   c) Amounts deducted from a payment for various mandatory tax obligations.

   d) Expenses related to utility bills and monthly subscription services.

6. What is a distinguishing feature of a Fixed Deposit (FD) compared to a regular savings account? **[1]**

   a) Provides a fixed rate of interest for a predetermined period

   b) Offers uncertain but potentially high returns over time

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c) Allows frequent deposits and withdrawals without penalty

d) Primarily used for emergency funds due to immediate liquidity

7. Which of the following scenarios best exemplifies the concept of 'return' in the context of personal finance? **[1]**

a) The monthly premium paid for an automobile insurance policy.

b) The extra funds received from a certificate of deposit at maturity.

c) The possibility that a business will not repay its financial obligations.

d) A decrease in the value of shares held in a company over six months.

8. What happens to the purchasing power of money when inflation occurs? **[1]**

a) It fluctuates unpredictably without a clear trend.

b) It increases, allowing more goods to be bought.

c) It remains unchanged despite price changes.

d) It decreases, meaning less can be bought with the same amount.

9. What does 'spending' primarily refer to? **[1]**

a) The periodic review and adjustment of a personal financial budget plan.

b) Accumulating monetary assets for long-term growth and capital appreciation.

c) The allocation of money for the acquisition of goods and various services.

d) The diversion of funds into a designated savings account for emergency use.

10. Which of the following is considered a primary component of personal financial management? **[1]**

a) Establishing and maintaining a detailed record of daily food intake.

b) Maximizing all discretionary spending at every opportunity.

c) The systematic planning, utilization, and preservation of financial resources.

d) Ignoring long-term financial goals in favor of immediate gratification.

11. When income is irregular, what is a recommended approach for budgeting to maintain feasibility? **[1]**

a) Base the budget on the highest potential income to aim for ambitious goals.

b) Create a new budget every week to account for constant fluctuations.

c) Calculate the average of past incomes and use that figure.

d) Anchor the budget on the lowest expected income to ensure the plan remains possible.

12. What is the term for the original amount of money on which simple interest is calculated? **[1]**

a) Maturity Amount

b) Future Value

c) Principal

d) Interest Rate

13. Which of the following best describes the primary goal of investing, as opposed to saving? **[1]**

a) Prioritizing security and easy liquidity of capital

b) Focusing on growing money over time, typically with higher risk

c) Maintaining predictable returns with

d) Ensuring immediate access to funds

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no possibility of loss

for unforeseen expenses

14. Which of the following is identified as a potential cause of inflation related to production? **[1]**

a) Decreased government taxation on imported goods.

b) An increase in the overall efficiency of manufacturing.

c) Higher costs of raw materials or energy resources.

d) Reduced consumer spending on non-essential items.

15. What is the primary purpose of personal income tax for a government? **[1]**

a) To accumulate wealth for private businesses.

b) To fund essential public services and infrastructure.

c) To directly subsidize individual savings accounts.

d) To provide luxury goods and services to high-income earners.

16. What type of expenses are consistent in amount and occur regularly, such as housing payments or subscription services? **[1]**

a) Unexpected expenses, as they are unplanned expenditures.

b) Fixed expenses, as they are regular and often of a similar amount each period.

c) Discretionary expenses, as they can be easily adjusted.

d) Variable expenses, due to their fluctuating nature.

17. Which of the following sources is typically considered taxable income for an individual? **[1]**

a) Reimbursements for business expenses.

b) Gifts received from family members.

c) Inheritances received through legal means.

d) Wages earned from employment.

18. What does the term 'principal' represent? **[1]**

a) The annual percentage rate.

b) The original amount of money deposited or borrowed.

c) The total interest earned.

d) The time period of the investment.

19. Which of the following options allows investors to purchase ownership stakes in a company, with potential for value appreciation and dividend payments? **[1]**

a) Fixed Deposit account

b) Stock (share)

c) Government bond

d) Recurring Deposit account

20. Which of the following best describes the fundamental concept of inflation? **[1]**

a) A reduction in the overall cost of production for businesses.

b) An increase in the total supply of available products.

c) A general rise in the prices of goods and services over time.

d) A decrease in the scarcity of goods and services.

21. Which investment option involves lending money to a government or corporation in exchange for regular interest payments and the return of the principal amount at maturity? **[1]**

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a) Mutual Fund

b) Stock (share)

c) Bond

d) Exchange Traded Fund (ETF)

22. Which mathematical relationship accurately represents a balanced budget? **[1]**

a) $\text{Income} = \text{Total expenses} \times \text{Savings}$ b) $\text{Income} < \text{Total expenses} + \text{Savings}$

c) $\text{Income} = \text{Total expenses} - \text{Savings}$ d) $\text{Income} = \text{Total expenses} + \text{Savings}$

23. What is the primary characteristic of an 'investment' in personal financial management? **[1]**

a) It constitutes deploying capital with the anticipation of future growth or income.

b) It is exclusively concerned with the settlement of outstanding financial liabilities.

c) It refers to setting aside funds for unexpected, short-term needs.

d) It involves the immediate consumption of goods and services.

24. What is the fundamental reason that good personal financial management is deemed important? **[1]**

a) It is crucial because financial resources are inherently limited for most people.

b) It guarantees an individual will achieve immense personal wealth instantly.

c) It ensures that all financial wants can be satisfied without any constraint.

d) It primarily facilitates the acquisition of numerous luxury consumer goods.

25. Which of the following scenarios illustrates 'inflation risk' for an investor? **[1]**

a) Changes in central bank policies leading to a decline in bond prices.

b) A company failing to pay its bondholders the promised interest payments.

c) The market value of an equity portfolio decreasing significantly.

d) A fixed deposit yielding 4% interest when general prices are rising at 6% annually.

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26. Match the items in List I with those in List II. **[1]**

List I	List II
(A) Investment	(I) Money for daily travel
(B) Need	(II) Discretionary spending on luxury items
(C) Want	(III) Allocating funds to acquire equity in a growing enterprise
(D) Spending	(IV) Purchase of groceries

a) A-III, B-IV, C-II, D-I

b) A-IV, B-III, C-I, D-II

c) A-II, B-I, C-IV, D-III

d) A-I, B-II, C-III, D-IV

27. Match the items in List I with those in List II. **[1]**

List I	List II
(A) Fixed income	(I) Money set aside for future use
(B) Saving	(II) Monthly salary or pension
(C) Personal financial management	(III) Planning, using, and protecting money

(D) Financial stability	(IV) Ability to manage expenses and future goals

a) A-I, B-II, C-IV, D-III
b) A-IV, B-III, C-I, D-II
c) A-III, B-IV, C-II, D-I
d) A-II, B-I, C-III, D-IV

28. Match the items in List I with those in List II. **[1]**

List I	List II
(A) Risk	(I) Chance of borrower default
(B) Return	(II) Gain from investment; interest, dividends, or value increase
(C) Credit risk	(III) Regular payment to insurer
(D) Premium	(IV) Variability in actual vs. expected outcome

a) A-II, B-IV, C-I, D-III
b) A-IV, B-II, C-I, D-III
c) A-IV, B-II, C-III, D-I
d) A-I, B-II, C-IV, D-III

29. **Assertion (A):** Prioritizing 'wants' over 'needs' in everyday spending is a sustainable strategy for achieving long-term financial goals. **[1]**
Reason (R): 'Wants' are discretionary expenses that, if consistently prioritized, can reduce the funds available for essential needs and savings for future goals.

a) Both A and R are true, and R is the correct explanation of A
b) Both A and R are true, but R is not the correct explanation of A
c) A is true, but R is false
d) A is false, but R is true

30. **Assertion (A):** Effective financial planning for higher education, which is a long-term goal, should begin several years in advance. **[1]**
Reason (R): Long-term financial goals typically require significant capital and benefit from the power of compound growth over extended periods.

a) Both A and R are true, and R is the correct explanation of A
b) Both A and R are true, but R is not the correct explanation of A
c) A is true, but R is false
d) A is false, but R is true

31. **Assertion (A):** During periods of inflation, individuals holding fixed-income investments, such as long-term bonds with a constant interest rate, experience a decline in the real value of their returns. **[1]**
Reason (R): The nominal interest rate on such investments automatically adjusts upwards to match the inflation rate, safeguarding the real value of the returns.

a) Both A and R are true, and R is the correct explanation of A
b) Both A and R are true, but R is not the correct explanation of A
c) A is true, but R is false
d) A is false, but R is true

32. **Assertion (A):** Holding emergency funds in a standard savings account, despite low interest rates, is a sound financial strategy for immediate liquidity needs. **[1]**
Reason (R): Savings accounts typically offer high growth potential, making them ideal for long-term wealth accumulation.

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a) Both A and R are true, and R is the correct explanation of A

b) Both A and R are true, but R is not the correct explanation of A

c) A is true, but R is false

d) A is false, but R is true

33. **Assertion (A):** When money is invested with compound interest, the total interest earned over five years will always be greater than if the same principal were invested with simple interest at the same annual rate for the same duration. **[1]**

Reason (R): Compound interest calculates interest on the initial principal only, whereas simple interest calculates interest on both the principal and the accumulated interest from previous periods.

a) Both A and R are true, and R is the correct explanation of A

b) Both A and R are true, but R is not the correct explanation of A

c) A is true, but R is false

d) A is false, but R is true

34. Identify and list the four key components of personal finance as a system. **[2]**

35. Describe the primary difference between credit risk and market risk in the context of investment types. **[2]**

36. List two key characteristics that distinguish 'Exchange Traded Funds (ETFs)' from actively managed mutual funds, particularly concerning their trading mechanism and cost structure. **[2]**

37. Identify two crucial initial steps in preparing a personal or family budget, according to established budgeting principles. **[2]**

38. Explain the concept of a 'basic exemption limit' in the context of personal income tax, and justify its implementation in a taxation system. **[2]**

39. Differentiate between needs and wants in the context of personal financial management, providing an example for each. **[2]**

40. What is personal financial management, and why is it considered important for an individual's well-being? **[2]**

41. Explain how a progressive tax system, where tax rates increase with income, reflects the principle of 'ability to pay'. **[2]**

42. Describe three distinct sources from which an individual's income can be derived, and for each source, provide a brief example. **[2]**

43. Elaborate on how health insurance helps individuals manage financial challenges associated with medical needs. **[2]**

44. Describe why insurance is considered a valuable tool for managing financial risk, rather than eliminating it entirely. **[2]**

45. Explain the fundamental relationship between risk and return in financial investments. **[2]**

46. Explain why understanding whether income is fixed or variable is an important aspect of personal financial management. **[2]**

47. Explain the fundamental difference between 'saving' and 'investing' in the context of personal finance, highlighting their primary objectives. **[2]**

48. Explain the significance of treating savings as a 'fixed expense' in a personal budget. How does this approach benefit an individual's financial goals? **[2]**

49. Compare and contrast 'Stocks' and 'Bonds' as investment avenues, specifically addressing their **[2]**

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typical risk-return profiles and the nature of an investor's claim.

50. Explain why a 'Savings Account' is suitable for short-term financial needs and emergencies, even if it offers relatively low-interest rates, in contrast to investment options. **[2]**
51. Describe the primary purpose of personal income tax from the perspective of government functionality. **[3]**
52. Describe the core purpose of life insurance and health insurance. How do they fundamentally differ in the financial protection they offer? **[3]**
53. Discuss two distinct types of income that typically fall under the purview of personal income tax. **[3]**
54. Describe why consistent saving is considered a critical component of sound personal financial management, even for small amounts. **[3]**
55. Explain how the concept of 'ability to pay' is integrated into many personal income tax systems and its implications for taxpayers. **[3]**
56. Explain the concept of 'financial stability' and illustrate two key characteristics of an individual or family considered financially stable. **[3]**
57. Differentiate between inflation caused by 'higher costs of production' and inflation caused by 'higher demand', outlining the primary driver in each case. **[3]**
58. Explain the fundamental difference in how simple interest and compound interest are calculated, and how this difference impacts the total return on an investment over an extended period. **[3]**
59. Explain why the effect of compounding becomes more significant as the investment duration increases, even with the same interest rate. **[3]**
60. Explain why savings accounts and certain fixed-income options are typically considered low-risk investments. What is a primary risk associated with these options? **[3]**
61. Justify how understanding the nature of one's income (fixed vs. variable) can significantly impact the effectiveness of personal financial planning. **[3]**
62. What is the primary role of insurance in personal finance, and what are three key characteristics of losses that insurance typically protects against? **[3]**
63. **Read the given source carefully and answer the questions that follow:** **[4]**

Rohan is a Class XI student who receives ₹ 3,000 as monthly pocket money. He uses this money for transport, snacks, mobile recharge, and occasional outings with friends. Initially, he spent most of his money within the first two weeks and often had to ask his parents for extra money. After learning about personal financial management, he started tracking his expenses. He separated his spending into needs and wants. He allocated ₹ 1,500 for transport and recharge, ₹800 for food and recreation, and decided to save ₹ 700 every month. His goal was to purchase a tablet costing ₹8,400 within a year. He also maintained a notebook to record daily expenses. Over time, he noticed that unnecessary spending on online games was reducing his savings. By limiting such expenses, he stayed within his budget and gradually built his savings. His parents appreciated his financial discipline. Through proper planning, Rohan learned how managing income, spending, saving, and future goals can help achieve financial stability without borrowing money or facing financial stress.

Questions:

a. What is personal financial management? **(1)**

b. What are financial goals? **(1)**

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c. How did Rohan's financial management help him achieve financial stability? **(2)**

64. **Read the given source carefully and answer the questions that follow:** **[4]**

Seema's parents were planning for their family's future. They had savings in a bank account, investments in mutual funds, and a fixed deposit for medium-term goals. While discussing finances, they explained to Seema that every financial decision involves some level of risk. Savings accounts were relatively safe but offered lower returns. Mutual funds had the potential for higher returns but their value could rise or fall depending on market conditions. To protect the family from unexpected financial shocks, they purchased health insurance, life insurance, and motor insurance. A few months later, their car was damaged in an accident. The motor insurance policy covered a major part of the repair costs. This experience demonstrated how insurance works as a financial safety tool. Seema learned that balancing risk and return is important, and that insurance helps protect individuals and families against large unexpected expenses that could otherwise affect long-term financial goals.

Questions:

a. What is risk in personal finance? **(1)**

b. What is motor insurance? **(1)**

c. Why is insurance considered an important financial protection tool? **(2)**

65. **Read the given source carefully and answer the questions that follow:** **[4]**

Aarti's family decided to improve their financial habits after facing difficulties during an unexpected medical emergency. Although they had a steady monthly income, they had very little savings because most of their earnings were spent immediately. They began maintaining records of income and expenditure, distinguishing between necessary expenses and optional spending. They set aside a fixed portion of income for emergency savings and another amount for future goals such as higher education for their children. Within a year, they created an emergency fund and reduced their dependence on borrowing. They also became more confident in handling financial challenges because they had planned ahead. The experience taught them that financial management involves not only earning money but also making wise decisions about spending, saving, and future planning.

Questions:

a. What is saving? **(1)**

b. What is financial stability? **(1)**

c. How did financial planning improve Aarti's family's situation? **(2)**

66. **Read the given source carefully and answer the questions that follow:** **[4]**

Kunal receives ₹ 2,500 as monthly allowance. Earlier, he spent most of it on snacks, online subscriptions, and entertainment. At the end of every month, he often found himself short of money. His teacher advised him to prepare a budget. Kunal listed his monthly income and expenses, separating fixed expenses such as school-related costs from variable expenses such as recreation. He decided to save ₹ 500 every month and limit unnecessary spending. After three months, he noticed that budgeting helped him avoid wasteful purchases and maintain better control over his money. He also used a simple mobile application to record expenses daily. This allowed him to compare actual spending with planned spending and make adjustments

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whenever necessary. Gradually, he developed discipline and learned the value of planning before spending.

Questions:

a. What are variable expenses? **(1)**

b. Why should savings be included in a budget? **(1)**

c. How did budgeting improve Kunal's financial behaviour? **(2)**

67. **Read the given source carefully and answer the questions that follow:** **[4]**

Priya received ₹ 10,000 from her grandparents and wanted to save it for three years. She learned about simple and compound interest from her economics teacher. Under simple interest, she would earn interest only on the original amount deposited. Under compound interest, interest would be calculated on both the principal and previously earned interest. To understand the difference, she compared the returns offered by two banks. One bank offered simple interest at 6% per year, while another offered compound interest at the same rate. After calculating the expected returns, she realised that the compound interest option would provide a higher final amount because interest would continue earning additional interest each year. Priya chose the compound interest account because her goal was long-term growth rather than immediate access to money. This experience helped her understand the importance of time and the power of compounding in increasing savings over the long run.

Questions:

a. What is simple interest? **(1)**

b. What is compound interest? **(1)**

c. Why did Priya prefer compound interest over simple interest? **(2)**

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68. **Read the given source carefully and answer the questions that follow:** **[4]**

Meera's family wanted to improve their financial management. At the beginning of every month, they prepared a budget. Their monthly income was ₹ 50,000. First, they listed fixed expenses such as rent, school fees, internet charges, and electricity bills. Next, they estimated variable expenses like groceries, transport, and entertainment. They also decided to save ₹ 5,000 every month for emergencies. During one month, transport expenses increased because fuel prices rose unexpectedly. To balance the budget, the family reduced spending on dining out and entertainment. At the end of the month, they reviewed their expenses and compared them with the planned budget. This helped them identify unnecessary spending and improve future budgeting decisions. Over time, budgeting helped them reduce financial stress, build savings, and ensure that their income was used efficiently. The family understood that budgeting was not about restricting spending completely but about making informed choices and prioritising important needs and goals.

Questions:

a. What is a budget? **(1)**

b. What are fixed expenses? **(1)**

c. How did budgeting help Meera's family manage rising transport costs? **(2)**

69. Differentiate between 'credit risk' and 'market risk' as they pertain to financial investments. Explain how an investor might encounter each type of risk. **[5]**

70. Differentiate between short-term, medium-term, and long-term financial goals, providing an **[5]**

example for each category.

71. Explain the importance of regularly tracking and adjusting a budget, rather than treating it as a one-time document. Provide an illustration of a scenario where adjustment becomes necessary. **[5]**

72. Differentiate between 'interest rate risk' and 'inflation risk' in the context of financial planning. Provide an example for each to clarify their impact. **[5]**

73. Justify why compound interest is often referred to as 'interest on interest' and explain its implications for long-term investments. **[5]**

74. Explain how insurance acts as a mechanism for managing financial risk. Include a discussion of why it is considered useful and mention the role of a 'premium'. **[5]**

75. Describe the key components that contribute to financial stability for an individual or family, and explain how each component interrelates to build a secure financial position. **[5]**

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Solution
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1. **(b)** The calculation of interest on previously earned interest.
Explanation:
Compound interest includes the calculation of interest on the interest already accumulated, which leads to a larger overall amount compared to simple interest that only calculates interest on the initial principal.

2. **(a)** Elevated levels of associated financial risk.
Explanation:
A fundamental principle in finance is that higher expected returns generally correspond with higher levels of risk, as investors are compensated for taking on more uncertainty.

3. **(d)** Diversification and professional management of investments
Explanation:
Mutual funds offer investors diversification by pooling money across multiple assets and benefit from professional management to make investment decisions.

4. **(c)** Setting aside a portion of current earnings for subsequent future utilization.
Explanation:
Saving implies allocating a part of current income to be used at a later time, often for specific goals or unexpected events.

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5. **(a)** Financial gifts received from relatives or earnings from part-time work.
Explanation:
Income refers to money received, such as financial gifts or earnings from part-time work, which contribute to an individual's available funds.

6. **(a)** Provides a fixed rate of interest for a predetermined period
Explanation:
A Fixed Deposit (FD) is characterized by a fixed period of deposit and a fixed, known rate of interest, offering predictable returns.

7. **(b)** The extra funds received from a certificate of deposit at maturity.
Explanation:
Return refers to the gain or profit derived from an investment, such as the interest earned on a certificate of deposit.

8. **(d)** It decreases, meaning less can be bought with the same amount.
Explanation:
When inflation rises, the same amount of money buys fewer items, directly indicating a decrease in its purchasing power.

9. **(c)** The allocation of money for the acquisition of goods and various services.
Explanation:
Spending refers to the use of money to purchase goods and services that satisfy daily needs, wants, or obligations. It includes expenses such as food, transportation, housing, education, and

entertainment. Unlike saving or investing, spending involves the direct exchange of money for products or services. Effective management of spending is an important aspect of personal financial planning, as it helps individuals stay within their budget and achieve their financial goals.

10.

(c) The systematic planning, utilization, and preservation of financial resources.
Explanation:
Personal financial management involves planning how money is used, saving it, and protecting it for various purposes, aligning with a systematic approach to financial resources.

11.

(d) Anchor the budget on the lowest expected income to ensure the plan remains possible.
Explanation:
Basing a budget on the lowest expected income when income is irregular helps ensure that the budget remains achievable even during less profitable periods, preventing unnecessary stress and financial shortfalls.

12.

(c) Principal
Explanation:
The 'principal' is defined as the original amount of money on which simple interest is calculated.

13.

(b) Focusing on growing money over time, typically with higher risk
Explanation:
Investing primarily aims to grow money over time and generally involves a higher level of risk compared to saving.

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14.

(c) Higher costs of raw materials or energy resources.
Explanation:
Higher costs of production, such as increased prices for fuel, electricity, or raw materials, are a common cause of inflation, often referred to as cost-push inflation.

15.

(b) To fund essential public services and infrastructure.
Explanation:
The primary purpose of personal income tax is to generate revenue for governments to fund essential public services and infrastructure, which benefit all citizens.

16.

(b) Fixed expenses, as they are regular and often of a similar amount each period.
Explanation:
Fixed expenses are those that are consistent and often similar in amount each budgetary period, such as rent, utility bills, or loan payments, which are not easily changed.

17.

(d) Wages earned from employment.
Explanation:
Wages earned from employment are a common and explicit source of income subject to personal income tax.

18.

(b) The original amount of money deposited or borrowed.

Explanation:

The principal is the initial amount of money that is invested, deposited, or borrowed before any interest is added or charged. It serves as the base amount on which interest is calculated in both simple and compound interest. For example, if a person deposits ₹ 10,000 in a bank account, ₹ 10,000 is the principal. Any interest earned over time is calculated using this original amount as the starting point.

19.

(b) Stock (share)

Explanation:

A stock represents part-ownership in a company. Its value can increase, and some companies pay dividends to shareholders.

20.

(c) A general rise in the prices of goods and services over time.

Explanation:

Inflation is defined as a general rise in the prices of goods and services over time, leading to a decrease in the purchasing power of money.

21.

(c) Bond

Explanation:

A bond represents a loan made by an investor to a borrower (government or corporate) in exchange for periodic interest payments and the return of the principal at the bond's maturity.

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22.

(d) $\text{Income} = \text{Total expenses} + \text{Savings}$

Explanation:

A balanced budget ensures that all incoming money is accounted for by covering total expenses and setting aside funds for savings. Therefore, Income equals the sum of Total expenses and Savings.

23. **(a)** It constitutes deploying capital with the anticipation of future growth or income.

Explanation:

Investment involves placing money into assets or ventures with the expectation that it will generate income or appreciate in value over time.

24. **(a)** It is crucial because financial resources are inherently limited for most people.

Explanation:

Good personal financial management is important because financial resources are finite, and individuals must make strategic choices about how to allocate them to cover needs and wants.

25.

(d) A fixed deposit yielding 4% interest when general prices are rising at 6% annually.

Explanation:

Inflation risk occurs when the purchasing power of an investment's return is eroded by rising prices, meaning that despite monetary gains, the real value of the money has decreased.

26. **(a)** A-III, B-IV, C-II, D-I

Explanation:

- Investment (A) involves putting money into assets that may grow, like acquiring equity (III).

- A need (B) is essential, such as the purchase of groceries (IV).
- A want (C) is a non-essential item, like discretionary spending on luxury items (II).
- Spending (D) is the general use of money for goods and services, such as money for daily travel (I).

27.

(d) A-II, B-I, C-III, D-IV
Explanation:

- Fixed income (A) is regular and predictable, such as a monthly salary or pension (II).
- Saving (B) is the act of setting money aside for future use (I).
- Personal financial management (C) encompasses planning, using, and protecting money (III).
- Financial stability (D) implies the ability to manage present expenses and work towards future goals (IV).

28.

(b) A-IV, B-II, C-I, D-III
Explanation:

- **Risk** is the chance that the actual return will be different from what was expected, including the possibility of losing money. This matches **(IV) Variability in actual vs. expected outcome**.
- **Return** is the gain expected from saving or investing, which can come from interest, dividends, or an increase in investment value. This matches **(II) Gain from investment; interest, dividends, or value increase**.
- **Credit risk** is the chance that a borrower may fail to repay. This matches **(I) Chance of borrower default**.
- **Premium** is a regular amount paid to an insurance company. This matches **(III) Regular payment to insurer**.

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29.

(d) A is false, but R is true
Explanation:

- **Assertion (A) is false:** Prioritizing 'wants' over 'needs' is generally an unsustainable strategy. It can lead to unmet essential obligations, accumulation of debt, and an inability to save for important long-term goals.
- **Reason (R) is true:** 'Wants' are non-essential expenses and are by definition discretionary. If they are consistently given precedence, they will consume a larger portion of income, leaving insufficient funds for necessities ('needs') and for saving or investing towards future financial objectives.

30. **(a)** Both A and R are true, and R is the correct explanation of A
Explanation:

- **Assertion (A) is true:** Planning for significant long-term goals like higher education requires extensive preparation and should ideally begin years in advance to accumulate the necessary funds.
- **Reason (R) is true:** Long-term financial goals, especially those involving substantial costs, are best achieved by leveraging compound interest over many years. This allows smaller, consistent contributions to grow into a much larger sum.
- **R is the correct explanation of A:** The reason directly explains *why* early planning for long-term goals (like higher education) is crucial: the need for substantial capital and the benefit of compound growth over time.

31.

(c) A is true, but R is false
Explanation:

Assertion (A) is true: If inflation increases while the nominal return from a fixed-income investment remains constant, the real purchasing power of those returns diminishes significantly. Reason (R) is false: Fixed-income investments have set nominal interest rates that do not automatically adjust upwards with inflation. This is precisely why their real value decreases during inflationary periods, making them less attractive unless anticipated inflation is factored into the initial rate.

32.

(c) A is true, but R is false

Explanation:

The assertion is true because savings accounts provide easy access and predictability, which are crucial for emergency funds. However, the reason is false because savings accounts are known for low interest rates and are not suitable for high growth or long-term wealth accumulation.

33.

(c) A is true, but R is false

Explanation:

- **Analysis of Assertion (A):** Compound interest generates interest on the principal plus any accumulated interest, leading to exponential growth. Simple interest only generates interest on the original principal. Therefore, for any period greater than one interest cycle (typically one year), compound interest will yield more interest than simple interest at the same rate. Thus, A is true.
- **Analysis of Reason (R):** The reason states that compound interest calculates interest on the initial principal only, which is incorrect. This statement describes simple interest. It then states that simple interest calculates interest on both the principal and accumulated interest, which is incorrect and describes compound interest. The definitions are swapped. Thus, R is false.

34. The **four key components of personal finance** are:
    i. **Income** - Money earned from sources such as salaries, wages, business profits, or investments.
    ii. **Spending (Expenses)** - Money used for daily needs, bills, and other purchases.
    iii. **Saving** - Setting aside a portion of income for future needs and emergencies.
    iv. **Investing** - Using money to purchase assets that can generate returns and help grow wealth over time.
35. Market risk pertains to fluctuations in investment values due to overall market movements, affecting shares and equity funds. Credit risk, however, is specific to debt instruments like bonds, representing the possibility that the borrower may default on their repayment obligations, failing to pay interest or principal.
36. Two key characteristics distinguishing ETFs from actively managed mutual funds are:
    - **Trading Mechanism:** ETFs are traded on stock exchanges like individual shares throughout the day, while mutual funds are bought/sold at the day's closing Net Asset Value (NAV).
    - **Cost Structure:** ETFs often have lower expense ratios compared to actively managed mutual funds because many track an index rather than requiring extensive fund manager intervention.
37. Two crucial initial steps in preparing a personal or family budget are establishing the budget period and identifying all sources of income. Setting a budget period, such as weekly or monthly, provides a clear time frame for planning. Identifying income sources helps determine the total funds available for expenses, savings, and financial goals.
38. The basic exemption limit refers to a specific income threshold below which an individual is not liable to pay income tax.
    It is implemented to ensure that individuals with minimal earnings are not burdened by tax obligations, promoting equity and providing financial relief to lower-income groups, aligning with the principle of ability to pay.
39. Needs are essential goods and services required for survival and basic living, such as food, shelter, healthcare, and education. Wants are non-essential items that improve comfort or enjoyment but are

not necessary for survival. For example, purchasing groceries is a need, whereas buying the latest smartphone model for luxury or entertainment purposes is a want.

40. Personal financial management refers to the process an individual or family uses to plan, organize, direct, and control their financial activities. It is important because it enables meeting daily needs, avoiding debt, building savings for emergencies and future goals, and making informed financial decisions.
41. A progressive tax system applies higher tax rates to individuals with higher incomes. This reflects the 'ability to pay' principle by assuming that those who earn more can contribute a larger proportion of their income without significant hardship. It aims to distribute the tax burden more equitably, ensuring individuals with greater financial capacity contribute more to public services.
42. An individual's income can come from several sources. Employment income includes salaries or wages earned from a job. Business income refers to profits earned from running a business or self-employment. Investment income is generated from financial assets, such as interest from a savings account or dividends from shares. These sources together contribute to overall earnings.
43. Health insurance helps manage financial challenges by covering medical expenses arising from illness or injury. It reduces the direct out-of-pocket costs for services like hospital stays, doctor visits, and medications, ensuring access to necessary healthcare without significant financial strain on the individual or family's savings.
44. Insurance is valuable because it transfers the financial burden of certain unpredictable, high-cost events from an individual to an insurer. It does not prevent the event from happening, thereby not eliminating the risk, but it significantly mitigates the potentially devastating financial impact on the individual or family.
45. The fundamental concept is that higher expected returns typically necessitate taking on higher risk. Conversely, investments with lower risk generally offer lower potential returns. This relationship reflects the compensation investors require for assuming greater uncertainty regarding their investment's future value.
46. Understanding whether income is fixed or variable is important because it helps individuals create realistic budgets and manage their finances effectively. Fixed income provides predictable earnings, making financial planning easier. Variable income fluctuates over time, requiring more careful budgeting and saving. Recognizing the type of income helps ensure that expenses remain manageable and financial goals can be achieved.
47. Saving primarily focuses on preserving capital and ensuring easy access for short-term needs or emergencies. Investing, conversely, aims to grow wealth over a longer period, typically by taking on higher risk in pursuit of greater returns. Saving prioritizes safety; investing prioritizes growth.
48. Treating savings as a fixed expense means allocating a predetermined amount to savings upfront, before planning other spending. This prioritizes financial goals and emergencies, ensuring consistent progress towards objectives like purchasing assets or building an emergency fund, rather than saving only what remains.
49. Stocks represent ownership in a company, offering potentially higher returns but also higher risk due to fluctuating values. Bonds are loans to governments or companies, offering more stable, lower returns with less risk, and represent a creditor's claim rather than ownership.
50. A Savings Account is suitable for short-term needs due to its high liquidity and minimal risk. Funds are easily accessible for immediate use, which is critical during emergencies. While returns are low, the priority is principal preservation and ready availability, unlike investment options focused on long-term growth and higher risk.
51. The primary purpose of personal income tax from the government's perspective is to generate revenue needed to fund public services and carry out essential governmental functions. Income tax helps finance areas such as education, healthcare, transportation, public safety, defense, and infrastructure development. It also supports social welfare programs and administrative operations. By collecting taxes from individuals based on their income, governments obtain the financial resources necessary to promote economic development, maintain public services, and ensure the smooth functioning of society.

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52. Life insurance provides financial support to beneficiaries upon the policyholder's death, ensuring income replacement and financial stability for dependents. In contrast, health insurance covers medical expenses due to illness or injury incurred by the policyholder, helping to manage healthcare costs. The key difference is that life insurance protects against the financial consequences of death, while health insurance covers living medical expenses.
53. Two distinct types of income that typically fall under personal income tax are employment income and investment income. Employment income includes salaries, wages, bonuses, and other earnings received from work performed for an employer. Investment income includes earnings generated from financial assets, such as interest from savings accounts, dividends from shares, or returns from certain investments. Governments generally tax these income sources because they contribute to an individual's overall earnings and ability to pay taxes.
54. Consistent saving is crucial because it builds financial security for unexpected events like emergencies or job loss. It also enables achieving short-term goals and instills self-discipline in managing finances. Over time, even small, regular contributions can accumulate significantly, providing a foundation for future financial stability and investment opportunities.
55. The 'ability to pay' concept means individuals with higher incomes contribute a larger amount, often at progressive rates, to the tax system. This implies that as income increases, the tax rate applied to that income also rises. It aims for a more equitable distribution of the tax burden, where those with greater financial capacity contribute proportionally more to public funds.
56. Financial stability refers to the ability of an individual or family to meet current financial obligations, handle unexpected expenses, and work toward future financial goals without excessive stress. Two key characteristics of financial stability are a steady source of income, which ensures regular financial resources, and adequate savings or an emergency fund, which provides protection against unforeseen events. Together, these characteristics help maintain financial security, reduce dependence on debt, and support long-term financial well-being.
57. Inflation caused by higher costs of production is known as cost-push inflation. It occurs when the prices of raw materials, energy, or wages increase, forcing businesses to raise the prices of goods and services. Inflation caused by higher demand is called demand-pull inflation. It happens when consumer demand for goods and services exceeds the available supply. The primary driver of cost-push inflation is rising production costs, while demand-pull inflation is driven by excessive consumer demand.
58. The fundamental difference is that simple interest is calculated only on the original principal amount, while compound interest is calculated on both the principal and the accumulated interest from previous periods. As a result, simple interest grows at a constant rate, whereas compound interest grows at an increasing rate due to the “interest on interest” effect. Over an extended period, compound interest generates a significantly higher total return than simple interest for the same principal and interest rate.
59. The effect of compounding becomes more significant with increased duration because interest is earned on previously earned interest. As time passes, the principal amount effectively grows larger with each compounding period. This accelerating growth, where the gains themselves begin to generate returns, leads to an exponential increase in value that linear simple interest cannot match over longer investment horizons. The longer the duration, the more opportunities there are for this 'interest on interest' to accumulate.
60. Savings accounts and certain fixed-income options, such as government bonds and fixed deposits, are generally considered low-risk investments because they provide relatively stable returns and have a low likelihood of losing the principal amount. They are often backed by financial institutions or governments, which increases their safety. However, a primary risk associated with these investments is inflation risk, where rising prices reduce the purchasing power of the returns, causing the real value of earnings to decline over time.
61. Understanding whether income is fixed or variable is essential for effective personal financial planning because it influences budgeting, saving, and spending decisions. Fixed income provides predictable cash flow, making it easier to plan expenses and savings. Variable income fluctuates, requiring a more cautious approach, such as budgeting based on the lowest expected income and maintaining larger savings reserves. Recognizing the nature of income helps individuals create realistic financial plans, avoid overspending, and better manage financial uncertainties.

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62. The primary role of insurance in personal finance is to provide financial protection against unexpected events that could cause significant monetary loss. By paying a premium, individuals transfer certain risks to an insurance company, reducing the financial impact of unforeseen situations. Insurance typically protects against losses that are uncertain (may or may not occur), significant in financial impact, and accidental or unforeseen rather than intentional. This helps individuals maintain financial stability and recover more easily from adverse events.

63. a. Personal financial management is the process of planning, spending, saving, and protecting money wisely. It helps individuals and families meet daily needs, avoid unnecessary debt, build savings, and achieve future financial goals through proper financial planning and decision-making.
    b. Financial goals are objectives that people plan to achieve using money within a specific period. These may be short-term, medium-term, or long-term goals such as buying a gadget, pursuing higher education, or purchasing a house in the future.
    c. Rohan improved his financial stability by tracking expenses, separating needs from wants, and saving regularly. By reducing unnecessary spending and following a planned budget, he was able to accumulate savings steadily and move closer to purchasing his tablet without borrowing money.

64. a. Risk in personal finance refers to the possibility that actual financial outcomes may differ from expected outcomes. It includes the chance of losing money, earning lower returns, or facing unexpected financial difficulties.
    b. Motor insurance is a type of insurance that provides financial protection against losses arising from vehicle accidents, theft, damage, or liability claims, depending on the coverage included in the policy.
    c. Insurance helps individuals and families manage financial uncertainty by reducing the impact of costly unexpected events. By paying a relatively small premium, policyholders receive financial support when covered losses occur, protecting savings and long-term financial goals.

65. a. Saving refers to setting aside a portion of income for future use rather than spending it immediately. Savings help meet emergencies, achieve financial goals, and provide greater financial security over time.
    b. Financial stability means having sufficient income to meet regular expenses, maintain savings for emergencies, manage debt responsibly, and continue progressing toward future financial goals without major financial stress.
    c. Financial planning helped the family build savings, reduce unnecessary expenditure, and create an emergency fund. As a result, they became less dependent on borrowing and were better prepared to handle unexpected financial challenges and future goals.

66. a. Variable expenses are expenses that change from one period to another depending on usage and lifestyle choices. Examples include groceries, entertainment, fuel, clothing, and dining expenses, which may vary each month.
    b. Savings should be included in a budget because they help build emergency funds and achieve future goals. Treating savings as a planned expense ensures regular saving instead of saving only what remains after spending.
    c. Budgeting helped Kunal track expenses, reduce unnecessary purchases, and develop spending discipline. By comparing planned and actual expenses, he gained better control over his finances and successfully increased his monthly savings.

67. a. Simple interest is interest calculated only on the original principal amount deposited or borrowed. Since the interest remains fixed each period, the growth of money is steady and does not depend on previously earned interest.
    b. Compound interest is interest calculated on both the principal amount and the accumulated interest from previous periods. This allows savings to grow faster over time because interest itself earns additional interest.
    c. Priya selected compound interest because it generates higher returns over a longer period. Since interest is earned on both the principal and accumulated interest, the total amount grows faster compared to simple interest, making it suitable for long-term savings goals.

68. a. A budget is a financial plan that shows how income will be allocated among spending, saving, and future goals during a specific period. It helps individuals and families control expenses and use

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money more effectively.

b. Fixed expenses are regular expenses that usually remain the same each month. Examples include rent, school fees, internet charges, insurance premiums, and loan instalments. These expenses are generally difficult to reduce in the short term.

c. Budgeting enabled Meera's family to identify spending priorities and adjust their expenses when transport costs increased. By reducing entertainment and dining expenses, they maintained financial balance while continuing to meet essential needs and savings targets.

69. Credit risk and market risk are two distinct risks associated with financial investments. Credit risk refers to the possibility that a borrower or issuer of a financial instrument may fail to repay the principal or interest as promised. An investor may encounter this risk when investing in corporate bonds or lending money to entities with uncertain financial health. Market risk, on the other hand, arises from changes in market conditions such as interest rates, economic trends, or investor sentiment that affect the value of investments. An investor faces market risk when the prices of stocks, bonds, or mutual funds fluctuate due to overall market movements.
70. Financial goals are categorized by the time needed to achieve them. Short-term goals are usually completed within one year, such as purchasing a new mobile phone or building a small emergency fund. Medium-term goals typically take one to five years, such as saving for a home down payment or a vehicle. Long-term goals extend beyond five years and often involve major objectives, such as funding higher education, purchasing a house, or saving for retirement.
71. Regularly tracking and adjusting a budget is important because financial circumstances, expenses, and goals can change over time. A budget is a dynamic tool that helps individuals monitor spending, identify unnecessary expenses, and ensure that financial plans remain realistic and effective. Regular reviews allow adjustments to accommodate changes in income, prices, or personal priorities. For example, if an individual unexpectedly faces higher medical expenses or experiences a reduction in income, the budget may need to be revised by reducing discretionary spending and reallocating funds to essential needs. This flexibility helps maintain financial stability and supports the achievement of long-term financial goals.
72. Interest rate risk and inflation risk are distinct concepts affecting financial planning:
    - **Interest Rate Risk:** This is the risk that changes in general interest rates will negatively impact the value of a fixed-income investment, such as a bond. For instance, if you hold a bond yielding 4% and new bonds are issued at 6%, your existing bond becomes less attractive and its market value may fall.
    - **Inflation Risk:** This is the risk that rising prices (inflation) will erode the purchasing power of your investment returns over time. For example, if you have an investment yielding a 3% annual return but inflation is 5%, your real return is actually negative 2%, meaning your money buys less than it did before.
73. Compound interest is referred to as 'interest on interest' because, after the first period, the interest earned is added to the original principal. Subsequent interest calculations are then performed on this new, larger sum. This process causes the principal to grow over time, leading to accelerating interest earnings.

    For long-term investments, this has significant implications:
    - **Accelerated Growth:** The investment grows at an increasingly faster rate.
    - **Wealth Accumulation:** Even small initial investments can yield substantial returns over many years.
    - **Benefit of Time:** The longer the investment period, the more pronounced the effect of compounding becomes, making time a powerful factor in wealth creation.
74. Insurance acts as a mechanism for managing financial risk by transferring the potential financial burden of unexpected events from an individual to an insurance company. In exchange for a premium, which is a regular payment made by the policyholder, the insurer agrees to provide financial compensation if a covered loss occurs. Insurance is useful because it protects individuals and families from significant financial hardship caused by events such as accidents, illness, property damage, or theft. Instead of bearing the full cost of a loss, the insured person shares the risk with others through the insurance system. This promotes financial security, stability, and peace of mind during unforeseen circumstances.

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75. Financial stability is built through steady income, controlled spending, regular saving, and prudent investing. A steady income provides the resources needed to meet expenses and achieve financial goals. Controlled spending ensures that expenses do not exceed income. Regular saving creates an emergency fund and supports future needs, while prudent investing helps grow wealth over time. These components are interconnected: income funds spending, saving, and investing, while effective management of all four promotes long-term security and financial resilience.

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