

# Edmentum Personal Finance Practice Exam (Sample)

## Study Guide



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**SAMPLE**

## **Questions**

- 1. What does it mean to have equity in a home?**
  - A. The home is fully paid off**
  - B. The home's current value exceeds the mortgage balance**
  - C. The value of the home is decreasing**
  - D. The home is used as collateral for loans**
- 2. What is the purpose of the Dodd-Frank Act?**
  - A. To regulate financial derivatives**
  - B. To enhance consumer protection**
  - C. To eliminate bankruptcy laws**
  - D. To facilitate international trade**
- 3. Which term describes an agreement that is not verbally communicated but understood through actions?**
  - A. Written contract**
  - B. Implied contract**
  - C. Oral contract**
  - D. Formal contract**
- 4. What is the term for the amount of money made before expenses are deducted?**
  - A. Net income**
  - B. Gross income**
  - C. Operating income**
  - D. Disposable income**
- 5. What is a stock?**
  - A. A share in the ownership of a company**
  - B. A type of investment that guarantees returns**
  - C. A loan secured by real estate**
  - D. A government bond used for funding**

- 6. What is John's profession if he is dealing with a customer wanting to purchase stock?**
- A. Tax Accountant**
  - B. Insurance Sales Agent**
  - C. Real Estate Agent**
  - D. Financial Services Sales Agent**
- 7. What is financial literacy aimed at achieving?**
- A. Understanding complex investment strategies**
  - B. Equipping individuals to manage financial resources**
  - C. Providing knowledge about insurance products**
  - D. Helping people avoid all forms of debt**
- 8. How do financial advisors typically charge for their services?**
- A. By a fixed annual fee only**
  - B. Through a combination of hourly rates, flat fees, or commissions**
  - C. Based on the profits earned through investments**
  - D. Only through commissions on product sales**
- 9. What does it mean to live within your means?**
- A. Spending less than or equal to your income**
  - B. Accumulating credit card debt**
  - C. Investing all your savings**
  - D. Borrowing to cover living expenses**
- 10. What are the four major components of a will?**
- A. Proposal, directives, power of attorney, trusts.**
  - B. Statement, clauses, executor, amendments.**
  - C. Principle, conditions, beneficiary, notary.**
  - D. Purpose, considerations, executor, codicil.**

## **Answers**

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- 1. B**
- 2. B**
- 3. B**
- 4. B**
- 5. A**
- 6. D**
- 7. B**
- 8. B**
- 9. A**
- 10. D**

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## **Explanations**

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## 1. What does it mean to have equity in a home?

- A. The home is fully paid off
- B. The home's current value exceeds the mortgage balance**
- C. The value of the home is decreasing
- D. The home is used as collateral for loans

Equity in a home refers to the difference between the home's current market value and the outstanding balance on any mortgages or liens against it. Having equity means that the value of the home is greater than the debt owed on it, indicating ownership in the asset. When the current value exceeds the mortgage balance, it demonstrates that the homeowner has a financial stake in the property. This accumulated equity can serve as a resource for financial decisions, such as securing loans or selling the home for profit. The concept of equity is critical because it directly impacts a homeowner's financial health. If the home's value increases over time or if mortgage payments reduce the outstanding balance, equity grows. In contrast, if the home's value decreases or if additional loans are taken out against the home, it can reduce equity. Thus, the statement that the home's current value exceeds the mortgage balance accurately reflects what it means to possess equity in a home.

## 2. What is the purpose of the Dodd-Frank Act?

- A. To regulate financial derivatives
- B. To enhance consumer protection**
- C. To eliminate bankruptcy laws
- D. To facilitate international trade

The Dodd-Frank Act was enacted in response to the financial crisis of 2008 and its primary purpose is to enhance consumer protection within the financial services industry. This legislation aimed to create a more transparent and accountable financial system, which includes provisions designed to safeguard consumers from abusive practices. Key components include the establishment of the Consumer Financial Protection Bureau (CFPB), which is tasked with overseeing financial products and safeguarding consumers against deceptive practices. In addition to improving consumer protection, the Dodd-Frank Act also introduced reforms to increase the regulation of financial markets, aiming to prevent another crisis like that of 2008. While it does involve regulations regarding financial derivatives and some aspects of bankruptcy, the strongest and most emphasized goal of the Act is to provide enhanced protection for consumers in their financial transactions.

**3. Which term describes an agreement that is not verbally communicated but understood through actions?**

- A. Written contract**
- B. Implied contract**
- C. Oral contract**
- D. Formal contract**

The term that describes an agreement that is not verbally communicated but understood through actions is an implied contract. An implied contract arises when the actions of the parties involved suggest that they have an agreement, even if no explicit words or written documentation have been exchanged to formalize the terms. This type of contract is often based on social norms or customary practices, allowing parties to understand their obligations through their behavior and the context of their interactions. For instance, when someone orders food at a restaurant, there is an implied contract between the customer and the restaurant that the customer will pay for the meal after consumption, even though there is no formal agreement signed at the table. This understanding is derived from the common practices of dining out, illustrating how implied contracts operate in various scenarios without the need for spoken or written terms.

**4. What is the term for the amount of money made before expenses are deducted?**

- A. Net income**
- B. Gross income**
- C. Operating income**
- D. Disposable income**

The term for the amount of money made before expenses are deducted is gross income. Gross income refers to the total earnings received by an individual or entity, including wages, salaries, bonuses, and any other sources of income, without accounting for any deductions or taxes. This figure is often used to assess a person's or company's financial health before expenses such as taxes, insurance, and other costs associated with generating that income are taken into consideration. This understanding is fundamental in personal finance and taxation, as it lays the groundwork for evaluating one's financial situation and planning for both short-term and long-term expenditures. Gross income provides a clearer picture of total earnings, which is crucial for budgeting, saving, and financial planning.

## 5. What is a stock?

- A. A share in the ownership of a company**
- B. A type of investment that guarantees returns**
- C. A loan secured by real estate**
- D. A government bond used for funding**

A stock represents a share in the ownership of a company, which means that when you purchase a stock, you are buying a small part of that company. This ownership stake entitles you to a claim on part of the company's assets and earnings. Stocks can appreciate in value over time as the company grows, and they may also provide dividends, which are payments made to shareholders out of the company's profits. Understanding the nature of stocks is fundamental to investing, as they are a primary way individuals can participate in the market. By owning stocks, investors hope to profit from the company's success through increased stock prices and potential dividends. This distinguishes stocks from other financial instruments, such as loans or bonds, which represent debt rather than ownership.

## 6. What is John's profession if he is dealing with a customer wanting to purchase stock?

- A. Tax Accountant**
- B. Insurance Sales Agent**
- C. Real Estate Agent**
- D. Financial Services Sales Agent**

John's profession is that of a Financial Services Sales Agent because this role involves assisting customers in purchasing financial products, including stocks. Financial Services Sales Agents are knowledgeable about various investment options and provide guidance on stock purchases. They often work for brokerage firms or financial institutions, helping clients understand the market and make informed decisions regarding their investments. In contrast, a Tax Accountant focuses on preparing tax returns and providing advice on tax-related matters rather than stock purchases. An Insurance Sales Agent deals primarily with selling insurance policies and managing related inquiries. Similarly, a Real Estate Agent specializes in buying and selling properties, not financial investments like stocks. Therefore, the context of dealing specifically with stock purchases aligns John with the role of a Financial Services Sales Agent.

**7. What is financial literacy aimed at achieving?**

- A. Understanding complex investment strategies**
- B. Equipping individuals to manage financial resources**
- C. Providing knowledge about insurance products**
- D. Helping people avoid all forms of debt**

Financial literacy is primarily aimed at equipping individuals to manage financial resources effectively. This encompasses a broad range of skills and knowledge, including budgeting, saving, investing, and understanding personal finance principles. By fostering financial literacy, individuals gain the ability to make informed decisions regarding their money, which can lead to improved financial stability and wellbeing. While understanding complex investment strategies, knowledge about insurance products, and avoiding all forms of debt can be components of financial literacy, they are not its main objectives. Financial literacy encompasses a holistic approach to managing one's finances, making informed choices, and developing an understanding of financial concepts that impact day-to-day life. It empowers individuals to navigate various financial situations confidently, making it essential for overall financial health.

**8. How do financial advisors typically charge for their services?**

- A. By a fixed annual fee only**
- B. Through a combination of hourly rates, flat fees, or commissions**
- C. Based on the profits earned through investments**
- D. Only through commissions on product sales**

Financial advisors commonly use a combination of methods to charge for their services, which can include hourly rates, flat fees, or commissions. This multifaceted approach allows clients to choose a payment structure that best fits their financial situation and investment strategy. Hourly rates involve charging clients for the time spent on specific services, which can be beneficial for clients who may not require ongoing advice. Flat fees represent a set amount charged for specific services or a range of services over a given period, such as financial planning or portfolio reviews. Commissions can be earned by the advisor when they sell financial products, further contributing to their revenue. This varied fee structure accommodates different types of clients and their individual needs, ensuring that advisors can cater to a broader clientele and provide tailored financial guidance. Thus, the use of this combination underscores the flexibility and adaptability of financial advisory services to meet diverse client requirements.

## 9. What does it mean to live within your means?

**A. Spending less than or equal to your income**

**B. Accumulating credit card debt**

**C. Investing all your savings**

**D. Borrowing to cover living expenses**

Living within your means refers to the practice of spending less than or equal to your income. This principle is fundamental for maintaining financial stability and avoiding debt. When individuals live within their means, they ensure that their expenditures do not exceed their earnings, which helps them manage their finances effectively and saves them from the stress of financial overextension. This approach encourages budgeting and mindful spending habits, allowing individuals to allocate funds for necessary expenses, savings, and unexpected costs without resorting to debt. By sticking to their income limits, they can build better financial habits, prepare for future financial goals, and enhance their overall financial health. Thus, the notion of living within one's means is a crucial component of personal finance management that promotes sustainability and financial well-being.

## 10. What are the four major components of a will?

**A. Proposal, directives, power of attorney, trusts.**

**B. Statement, clauses, executor, amendments.**

**C. Principle, conditions, beneficiary, notary.**

**D. Purpose, considerations, executor, codicil.**

The four major components of a will primarily include the purpose of the will, considerations addressed within it, the appointment of an executor, and any codicils that may be associated with the will. Understanding each component is essential for the effective creation and execution of a will. The purpose outlines the intent of the will, establishing the framework for how the testator wishes to distribute their assets and care for any dependents after their passing. Considerations refer to the specific wishes and conditions set forth by the testator regarding asset distribution and any other directives that need to be taken into account. The executor is a crucial role, as this individual is responsible for carrying out the terms of the will, managing the deceased's estate, and ensuring that all assets are distributed according to the testator's wishes. This position requires trustworthiness and competence to handle the legal and financial responsibilities involved. Lastly, a codicil is an amendment or supplement to the will that allows the testator to make changes without having to write an entirely new document. This is particularly important for reflecting any updates in circumstances, such as births, deaths, or changes in asset ownership, ensuring that the will remains relevant and correctly represents the testator's current wishes. Together, these components ensure