

University of Central Florida (UCF) FIN3403 Business Finance Practice Exam 3 (Sample)

Study Guide



Everything you need from our exam experts!

This is a sample study guide. To access the full version with hundreds of questions,

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Introduction

Preparing for a certification exam can feel overwhelming, but with the right tools, it becomes an opportunity to build confidence, sharpen your skills, and move one step closer to your goals. At Examzify, we believe that effective exam preparation isn't just about memorization, it's about understanding the material, identifying knowledge gaps, and building the test-taking strategies that lead to success.

This guide was designed to help you do exactly that.

Whether you're preparing for a licensing exam, professional certification, or entry-level qualification, this book offers structured practice to reinforce key concepts. You'll find a wide range of multiple-choice questions, each followed by clear explanations to help you understand not just the right answer, but why it's correct.

The content in this guide is based on real-world exam objectives and aligned with the types of questions and topics commonly found on official tests. It's ideal for learners who want to:

- Practice answering questions under realistic conditions,
- Improve accuracy and speed,
- Review explanations to strengthen weak areas, and
- Approach the exam with greater confidence.

We recommend using this book not as a stand-alone study tool, but alongside other resources like flashcards, textbooks, or hands-on training. For best results, we recommend working through each question, reflecting on the explanation provided, and revisiting the topics that challenge you most.

Remember: successful test preparation isn't about getting every question right the first time, it's about learning from your mistakes and improving over time. Stay focused, trust the process, and know that every page you turn brings you closer to success.

Let's begin.

How to Use This Guide

This guide is designed to help you study more effectively and approach your exam with confidence. Whether you're reviewing for the first time or doing a final refresh, here's how to get the most out of your Examzify study guide:

1. Start with a Diagnostic Review

Skim through the questions to get a sense of what you know and what you need to focus on. Don't worry about getting everything right, your goal is to identify knowledge gaps early.

2. Study in Short, Focused Sessions

Break your study time into manageable blocks (e.g. 30 - 45 minutes). Review a handful of questions, reflect on the explanations, and take breaks to retain information better.

3. Learn from the Explanations

After answering a question, always read the explanation, even if you got it right. It reinforces key points, corrects misunderstandings, and teaches subtle distinctions between similar answers.

4. Track Your Progress

Use bookmarks or notes (if reading digitally) to mark difficult questions. Revisit these regularly and track improvements over time.

5. Simulate the Real Exam

Once you're comfortable, try taking a full set of questions without pausing. Set a timer and simulate test-day conditions to build confidence and time management skills.

6. Repeat and Review

Don't just study once, repetition builds retention. Re-attempt questions after a few days and revisit explanations to reinforce learning.

7. Use Other Tools

Pair this guide with other Examzify tools like flashcards, and digital practice tests to strengthen your preparation across formats.

There's no single right way to study, but consistent, thoughtful effort always wins. Use this guide flexibly — adapt the tips above to fit your pace and learning style. You've got this!

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Questions

- 1. How is market capitalization defined?**
 - A. Total liabilities of a company**
 - B. Total market value of outstanding shares**
 - C. Total equity held by shareholders**
 - D. Total revenue generated by a company**
- 2. What is the formula to solve for straight-line depreciation?**
 - A. Total cost of the asset divided by its market value**
 - B. Total cost of the asset divided by its class life**
 - C. Total cost of the asset multiplied by its class life**
 - D. Total cost of the asset multiplied by years of use**
- 3. What is the definition of cost of debt?**
 - A. Total expenses incurred by the company**
 - B. The rate of return required by investors**
 - C. The interest rate on existing loans**
 - D. The cost of equity financing**
- 4. In the case of Prescott Corporation, what is the pre-tax cost of debt using the bond's cash flow?**
 - A. 8.40%**
 - B. 10.00%**
 - C. 10.61%**
 - D. 9.50%**
- 5. What key component is NOT included in the Weighted Average Cost of Capital (WACC) calculation?**
 - A. Cost of equity**
 - B. Cost of common stock**
 - C. Cost of retained earnings**
 - D. Cost of treasury stock**

- 6. What is the pre-tax cost of debt for Prescott Corporation's bond if the market rate is 10% and flotation costs amount to \$50?**
- A. 9.5%**
 - B. 10.61%**
 - C. 11.0%**
 - D. 10.0%**
- 7. What is the annual savings in operating costs expected from the new production machine for Riverview Company?**
- A. \$75,000**
 - B. \$110,000**
 - C. \$100,000**
 - D. \$90,000**
- 8. What would be the present value of XYZ company stock if it is expected to pay a \$5.50 dividend and have a future price of \$120 with a required rate of return of 15%?**
- A. 109.13**
 - B. 115.00**
 - C. 120.00**
 - D. 100.00**
- 9. Which of the following factors influences a company's capital structure?**
- A. Only business risk**
 - B. Only the availability of financing**
 - C. Business risk, tax considerations, bankruptcy costs, and availability of financing**
 - D. Market trends and consumer preferences**
- 10. What does 'debt financing' entail?**
- A. Using personal savings to fund a company's operations.**
 - B. Investing in equity shares of a company.**
 - C. Borrowing funds to be repaid in the future with interest.**
 - D. Generating funds through issuing additional equity shares.**

Answers

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

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Explanations

1. How is market capitalization defined?

- A. Total liabilities of a company
- B. Total market value of outstanding shares**
- C. Total equity held by shareholders
- D. Total revenue generated by a company

Market capitalization is defined as the total market value of a company's outstanding shares of stock. It represents what the market believes a company is worth at any given time, based on the stock price and the number of shares that are currently outstanding. To calculate market capitalization, you multiply the current share price by the total number of outstanding shares. This figure is a crucial metric for investors, as it provides a quick way to gauge the size and value of a company compared to others in the market. Total liabilities, total equity, and total revenue each measure different aspects of a company's financial health but do not directly indicate its market value in the way market capitalization does. Total liabilities refer to what a company owes, total equity reflects the shareholders' ownership interest, and total revenue indicates the income generated from sales but doesn't encompass the entirety of a company's value in terms of investments and market perception. Thus, the definition that captures the essence of a company's market value is the total market value of outstanding shares.

2. What is the formula to solve for straight-line depreciation?

- A. Total cost of the asset divided by its market value
- B. Total cost of the asset divided by its class life**
- C. Total cost of the asset multiplied by its class life
- D. Total cost of the asset multiplied by years of use

The formula for straight-line depreciation is calculated by taking the total cost of the asset and dividing it by its useful life, often referred to as its class life. This method evenly allocates the cost of the asset over its useful life, which simplifies accounting and provides a clear understanding of the depreciation expense incurred in each accounting period. By using the total cost of the asset and dividing it by the total number of years it is expected to provide value (its class life), businesses can ensure that they are reflecting the gradual wearing out of the asset accurately in their financial statements. This method aligns with the matching principle in accounting, where expenses are recognized in the same period as the related revenues they help to generate. This approach results in a consistent annual depreciation amount, facilitating easier budgeting and forecasting for future expenses, and aiding stakeholders in assessing the company's asset management and performance over time.

3. What is the definition of cost of debt?

- A. Total expenses incurred by the company
- B. The rate of return required by investors**
- C. The interest rate on existing loans
- D. The cost of equity financing

The cost of debt refers specifically to the effective rate that a company pays on its borrowed funds. This is best encapsulated by the option that describes it as the rate of return required by investors. This definition encompasses the obligation of the company to provide a return to those who have lent it money. It is crucial for a firm to ensure that it can cover its debt obligations in order to maintain its creditworthiness and attract further investment. In a financial context, the cost of debt is typically calculated as the weighted average interest rate on all of the company's debt, taking into account the tax deductibility of interest expenses. Since interest payments on debt are generally tax-deductible, the actual out-of-pocket cost for a firm is reduced, making the return required by investors lower when considering the tax shield. Understanding this concept is fundamental for a company to effectively evaluate investment opportunities and manage its capital structure, balancing debt and equity to minimize its overall cost of capital. Therefore, the option that identifies the cost of debt as the rate of return required by investors aligns accurately with the accepted financial definition.

4. In the case of Prescott Corporation, what is the pre-tax cost of debt using the bond's cash flow?

- A. 8.40%
- B. 10.00%
- C. 10.61%**
- D. 9.50%

The pre-tax cost of debt represents the required return that lenders demand on the bond, based on its cash flows. To determine the pre-tax cost of debt, one typically calculates the yield to maturity (YTM) on the bonds, which considers the bond's current market price, coupon payments, and the time to maturity. In the case of Prescott Corporation, if the calculated pre-tax cost of debt is 10.61%, this indicates that the yield reflects all future cash flows from the bond, including both the periodic coupon payments and the repayment of the face value at maturity, discounted back to the present value based on the bond's current market price. The precise calculation involves using the bond's coupon rate, the bond's current price, the time remaining until maturity, and any differences between the bond's face value and market price. By effectively using these inputs, arriving at a cost of 10.61% signifies that it accurately captures the risk and return profile associated with Prescott Corporation's debt obligations in the context of prevailing market conditions. Therefore, a pre-tax cost of debt of 10.61% showcases a more comprehensive view of the bond's yield based on its cash flow dynamics, making it the correct choice for this scenario.

5. What key component is NOT included in the Weighted Average Cost of Capital (WACC) calculation?

- A. Cost of equity**
- B. Cost of common stock**
- C. Cost of retained earnings**
- D. Cost of treasury stock**

The Weighted Average Cost of Capital (WACC) is a method used to calculate a company's cost of capital, taking into account the weights of each capital component. The key components included in this calculation are the cost of equity, which represents the returns required by equity investors; the cost of common stock, which refers to the returns required by shareholders on their investments in the company's common equity; and the cost of retained earnings, which represents the opportunity cost of reinvesting profits back into the company instead of paying them out as dividends. Treasury stock, on the other hand, is stock that has been repurchased by the company and is not considered an outstanding share. It does not generate costs or returns for the company and is not included in the calculation of WACC. WACC focuses on the sources of capital that are actively being used to finance company operations and growth. Since treasury stock does not contribute to the financing of projects or operations, it is not relevant in the context of WACC. This distinction is critical for understanding how a company's financing costs are assessed and weighed in investment decisions.

6. What is the pre-tax cost of debt for Prescott Corporation's bond if the market rate is 10% and flotation costs amount to \$50?

- A. 9.5%**
- B. 10.61%**
- C. 11.0%**
- D. 10.0%**

To find the pre-tax cost of debt for Prescott Corporation's bond, we need to consider both the market rate of the bond and any flotation costs associated with issuing the bond. The market rate reflects the return that investors demand for the bond, which is given as 10%. Flotation costs are the expenses incurred when issuing the bond, and in this case, they amount to \$50. When calculating the cost of debt, we typically adjust the market rate for flotation costs, as these costs effectively increase the total amount that needs to be generated to cover the debt. If we assume that the bond is issued at par value (face value), the flotation cost impacts the effective yield on the bond. In this scenario, we can compute the effective cost in the following steps: 1. If the bond were issued at its face value, the coupon payment expected would be based on the 10% market rate on the face value of the bond. 2. However, the flotation cost decreases the actual proceeds the company receives from the bond issuance. For example, if the bond has a nominal value of \$1,000 and there is a flotation cost of \$50, then the net proceeds the company effectively receives from the bond would be \$1,000 -

7. What is the annual savings in operating costs expected from the new production machine for Riverview Company?

- A. \$75,000
- B. \$110,000**
- C. \$100,000
- D. \$90,000

To determine the annual savings in operating costs from the new production machine, one needs to analyze the projected efficiencies, cost reductions, and overall financial impact that the machine is expected to provide. A choice of \$110,000 indicates a specific estimate derived from understanding the anticipated operational improvements associated with the machine's implementation. This figure likely results from a comprehensive evaluation of factors such as reduced labor costs, lower maintenance expenses, increased production capacity, or enhanced energy efficiency, which collectively contribute to improved overall cost-effectiveness. Additionally, the calculation may involve comparing current operating costs with those expected after introducing the new machine, highlighting the extent to which the investment will benefit the company financially each year. Such analysis is vital in business finance as it helps companies like Riverview Company assess whether the investment in new technology will yield sufficient savings to justify the cost of the acquisition and implementation of the machine. In this context, an annual savings of \$110,000 reflects a strong, positive outcome for Riverview Company, underscoring the importance of making informed financial decisions based on detailed evaluations of potential investments.

8. What would be the present value of XYZ company stock if it is expected to pay a \$5.50 dividend and have a future price of \$120 with a required rate of return of 15%?

- A. 109.13**
- B. 115.00
- C. 120.00
- D. 100.00

To find the present value of XYZ company stock, you need to calculate the present value of the expected future cash flows, which include the dividend and the future selling price of the stock. The formula to calculate the present value (PV) of these cash flows is as follows: $PV = \frac{D}{(1 + r)} + \frac{P}{(1 + r)}$ Where: - (D) is the expected dividend (\$5.50), - (P) is the expected selling price (\$120), - (r) is the required rate of return (15% or 0.15). Now, you can calculate it step by step: 1. Calculate the present value of the dividend: $PV_{\text{dividend}} = \frac{5.50}{(1 + 0.15)} = \frac{5.50}{1.15} \approx 4.78$ 2. Calculate the present value of the future price: $PV_{\text{price}} = \frac{120}{(1 + 0.15)} = \frac{120}{1.15} \approx 104.35$ 3. Now, add both

9. Which of the following factors influences a company's capital structure?

- A. Only business risk**
- B. Only the availability of financing**
- C. Business risk, tax considerations, bankruptcy costs, and availability of financing**
- D. Market trends and consumer preferences**

Capital structure refers to the mix of debt and equity that a company uses to finance its operations and growth. The correct choice encompasses multiple factors that affect this crucial aspect of financial management. Business risk is fundamental since it reflects the operational risks inherent in a company's activities; higher business risk typically leads to a more conservative capital structure, as investors demand higher returns for taking on additional risk. Tax considerations also play a significant role, as interest payments on debt are tax-deductible, influencing a company's decision about how much debt to utilize in its capital structure. Additionally, bankruptcy costs are crucial; as a company increases its level of debt, the risk of bankruptcy rises, which could lead to higher costs and negatively impact the company's ability to obtain financing in the future. Lastly, the availability of financing is important because if financial institutions or investors are willing to provide capital, it affects how a firm can structure its capital. By encompassing all these factors, the correct answer reflects the complexity of decisions surrounding capital structure and how interconnected various elements influence this decision-making process within a firm.

10. What does 'debt financing' entail?

- A. Using personal savings to fund a company's operations.**
- B. Investing in equity shares of a company.**
- C. Borrowing funds to be repaid in the future with interest.**
- D. Generating funds through issuing additional equity shares.**

Debt financing refers to the process of borrowing money that must be repaid over time, typically with interest. This form of financing is crucial for businesses as it allows them to access capital without relinquishing ownership stakes. When a company engages in debt financing, it usually does so by issuing bonds or taking loans from financial institutions. The essential aspect of this strategy is the obligation to repay the borrowed amount along with interest, which represents the cost of borrowing. This structure enables businesses to leverage external funds for expansion, operational costs, or other investments, with the expectation that future revenues will exceed the cost of the debt. In contrast to the other options, which involve either utilizing personal savings, purchasing equity shares, or issuing more equity, debt financing is specifically centered on the concept of borrowing with a commitment to future repayment. This characteristic distinctly defines it within the broader context of financing strategies used by companies.

Next Steps

Congratulations on reaching the final section of this guide. You've taken a meaningful step toward passing your certification exam and advancing your career.

As you continue preparing, remember that consistent practice, review, and self-reflection are key to success. Make time to revisit difficult topics, simulate exam conditions, and track your progress along the way.

If you need help, have suggestions, or want to share feedback, we'd love to hear from you. Reach out to our team at hello@examzify.com.

Or visit your dedicated course page for more study tools and resources:

<https://ucf-fin3403-exam3.examzify.com>

We wish you the very best on your exam journey. You've got this!