

ACCA Advanced Financial Management (AFM) Practice Exam (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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Table of Contents

Copyright	1
Table of Contents	2
Introduction	3
How to Use This Guide	4
Questions	6
Answers	9
Explanations	11
Next Steps	17

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. Which of the following best describes the outcome of public industrial issues in terms of stock price?**
 - A. Increased volatility**
 - B. 3% stock price increase**
 - C. 3% stock price decline**
 - D. Market consensus**
- 2. What type of bond is classified as a junk bond?**
 - A. Bond with rating below Baa or BBB**
 - B. Bond that is repaid early**
 - C. Bond yielding low interest rates**
 - D. Bond guaranteed by the government**
- 3. What often occurs with both stock dividends and stock splits?**
 - A. They decrease the total assets**
 - B. They increase shares outstanding**
 - C. They reduce shareholder value**
 - D. They decrease market capitalization**
- 4. What do institutions prefer in times of financial uncertainty regarding their investments?**
 - A. High-risk assets**
 - B. Steady income sources**
 - C. Diversified portfolios**
 - D. Short-term investments**
- 5. Which option is favored by leftists in terms of capital distributions to shareholders?**
 - A. Dividends**
 - B. Stock repurchases**
 - C. Capital gains**
 - D. Revenue reinvestment**

- 6. What positive signal might stockholders interpret from a stock repurchase?**
- A. Management believes the stock is undervalued**
 - B. There is a planned merger**
 - C. The company is increasing dividends**
 - D. There is a strong demand for products**
- 7. What is usually offered to DRIP enrollees when a firm issues new stock?**
- A. Options to buy at current market price**
 - B. New stock at a discount from market price**
 - C. Existing shares at premium prices**
 - D. Fixed income securities**
- 8. What does 'underpricing' imply when issuing securities?**
- A. Setting prices only slightly above market value**
 - B. Issuing securities at an offering price below the true value**
 - C. Pricing securities based on demand**
 - D. Offering high returns on investments**
- 9. What impact do stock dividends have on cash reserves?**
- A. They increase cash reserves**
 - B. They do not affect cash reserves**
 - C. They decrease cash reserves**
 - D. They lead to immediate liquidity issues**
- 10. What is referred to as "greenmail" in stock repurchases?**
- A. Selling shares at a profit**
 - B. Buying off a hostile bidder at a premium**
 - C. Distributing dividends instead of repurchasing**
 - D. Issuing new stock**

Answers

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

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Explanations

1. Which of the following best describes the outcome of public industrial issues in terms of stock price?

- A. Increased volatility**
- B. 3% stock price increase**
- C. 3% stock price decline**
- D. Market consensus**

The option indicating a 3% stock price decline accurately reflects a scenario that can be observed following a public industrial issue. This outcome can result from a variety of factors including investor sentiment, market conditions, and the nature of the issue being disclosed. When a company faces a public industrial issue, it can lead to uncertainty and a potential loss of confidence among investors, prompting them to sell shares, which in turn lowers the stock price. If the public industrial issue is perceived as significant or damaging, it could result in a substantial markdown of the stock's value as investors reassess the company's risk profile and future earning potential. The notion of a specific percentage decline reflects the market's reaction to negative news and demonstrates how external factors can influence investor behavior and stock valuation. In contrast, the other outcomes such as increased volatility, a 3% stock price increase, or market consensus do not capture the common immediate effects typically associated with negative public disclosures. Volatility may occur, but it does not directly reflect a definitive outcome like a decline in stock price. A stock price increase, following negative news, would be atypical, and market consensus generally signifies a balanced view rather than a specific directional price change. Thus, the notion of a decline in stock price stands

2. What type of bond is classified as a junk bond?

- A. Bond with rating below Baa or BBB**
- B. Bond that is repaid early**
- C. Bond yielding low interest rates**
- D. Bond guaranteed by the government**

A bond classified as a junk bond is characterized by a lower credit rating, specifically one that falls below Baa from Moody's or BBB from Standard & Poor's. These ratings indicate a higher risk of default, meaning that the issuer may struggle to make interest payments or repay the principal when due. Investors typically demand higher yields on junk bonds to compensate for this increased risk. The classification of junk bonds is significant because it helps investors assess the risk-return profile of their investments. While they can potentially offer attractive returns, they also come with the possibility of high volatility and the chance of losing principal. Understanding this classification is crucial for investors considering their portfolio's risk exposure and investment strategy.

3. What often occurs with both stock dividends and stock splits?

- A. They decrease the total assets
- B. They increase shares outstanding**
- C. They reduce shareholder value
- D. They decrease market capitalization

The correct answer highlights a fundamental characteristic of both stock dividends and stock splits: they increase the number of shares outstanding. When a company issues a stock dividend, it distributes additional shares to existing shareholders proportional to their current holdings. For instance, a 10% stock dividend means that shareholders will receive an additional share for every ten shares they own, resulting in an increased total count of shares outstanding. Similarly, a stock split involves dividing existing shares into multiple new shares. For example, in a 2-for-1 split, each shareholder would end up with two shares for every one share previously held. This action also leads to an increase in the number of shares outstanding. In both cases, although the number of shares increases, the overall value of the company and the proportionate ownership of each shareholder remain unchanged, reflecting the intrinsic goal of these practices to enhance liquidity or manage share prices. This context reinforces why the chosen answer is accurate, emphasizing the nature of share distribution increases with both methods.

4. What do institutions prefer in times of financial uncertainty regarding their investments?

- A. High-risk assets
- B. Steady income sources**
- C. Diversified portfolios
- D. Short-term investments

In times of financial uncertainty, institutions tend to prefer steady income sources because these investments provide a reliable and consistent cash flow, which helps mitigate risk. When the financial landscape is volatile, the focus shifts towards preserving capital and ensuring that cash flows remain stable. Steady income sources, such as bonds or dividend-paying stocks, are less subject to market fluctuations and therefore offer more predictability in terms of returns. This approach allows institutions to manage their risk exposure effectively, as steady income can support ongoing operations without the need to sell off risky assets in a downturn. In contrast, high-risk assets may offer the potential for higher returns, but they also bring greater variability and potential losses, which are less appealing during uncertain times. A diversified portfolio can reduce risk but does not guarantee steady income; it may still include a mix of volatile assets. Short-term investments can provide liquidity, but they might not necessarily ensure stable income, especially in turbulent markets. Thus, the preference for steady income sources reflects a strategic choice to maintain financial stability and security during challenging economic periods.

5. Which option is favored by leftists in terms of capital distributions to shareholders?

- A. Dividends**
- B. Stock repurchases**
- C. Capital gains**
- D. Revenue reinvestment**

Leftists typically advocate for economic systems that prioritize social welfare and equitable distribution of resources, rather than maximizing shareholder value. In this context, the concept of capital distributions to shareholders can be interpreted in terms of broader societal impact and economic sustainability. The option of revenue reinvestment aligns with these principles, as it focuses on using profits to fund future growth, improve operations, or support community initiatives rather than directly distributing cash or resources to shareholders. This approach emphasizes the idea that companies should contribute to the economy and society at large, rather than solely enriching shareholders. Reinvesting profits can lead to job creation, innovation, and long-term stability, which are priorities often associated with leftist ideology. Dividends, stock repurchases, and capital gains primarily serve the interests of shareholders, focusing on immediate financial rewards rather than long-term value creation for the community. As such, those who favor leftist ideology would likely criticize these options for potentially exacerbating inequality and prioritizing profit over social responsibility. Thus, revenue reinvestment is the favored option as it aligns more closely with the principles of community benefit and economic equity.

6. What positive signal might stockholders interpret from a stock repurchase?

- A. Management believes the stock is undervalued**
- B. There is a planned merger**
- C. The company is increasing dividends**
- D. There is a strong demand for products**

When a company initiates a stock repurchase, it often signals to stockholders that management believes the company's shares are undervalued. This action can instill confidence in investors, as it suggests that the company sees potential for growth and believes that investing its own resources back into its stock is a more favorable use of capital than other alternatives, such as pursuing new projects or acquisitions. Stock buybacks can reduce the number of shares outstanding, potentially increasing earnings per share (EPS) and demonstrating management's commitment to enhancing shareholder value. This perception of undervaluation can encourage stockholders to view the company's prospects positively, as it reflects management's belief in the intrinsic worth of the business and its future performance. The other options, while relevant in different contexts, do not directly tie the positive signal of a stock repurchase to management's perspective on valuation. For example, a planned merger or increased dividends may not necessarily correlate with stock buybacks, and strong demand for products, while potentially leading to profitability, does not imply value assessment regarding the stock.

7. What is usually offered to DRIP enrollees when a firm issues new stock?

- A. Options to buy at current market price**
- B. New stock at a discount from market price**
- C. Existing shares at premium prices**
- D. Fixed income securities**

When a firm issues new stock as part of a Dividend Reinvestment Plan (DRIP), it typically offers the new stock at a discount from the current market price. This incentive encourages shareholders to reinvest their dividends into purchasing additional shares rather than taking cash. By offering new shares at a discount, the company maintains investor loyalty and reduces cash outflow while simultaneously supporting its share price. The option to provide shares at a discount also aligns with the firm's goal of increasing its equity base without incurring the costs associated with issuing new shares in the open market at full market value. This strategy is beneficial for both the company, which strengthens its capital position, and the investors who gain the advantage of acquiring shares at a reduced rate compared to the prevailing market price. The other options do not align with the common practices of a DRIP. Options to buy at the current market price, existing shares at premium prices, and fixed-income securities do not typically relate to the mechanics of DRIP offerings, which fundamentally focus on the reinvestment of dividends in a manner that enhances shareholder value.

8. What does 'underpricing' imply when issuing securities?

- A. Setting prices only slightly above market value**
- B. Issuing securities at an offering price below the true value**
- C. Pricing securities based on demand**
- D. Offering high returns on investments**

Underpricing, in the context of issuing securities, refers to the practice of setting the offering price of a security below its true market value. This strategy is often employed during an initial public offering (IPO) to ensure that the securities attract sufficient investor interest and are sold out quickly. By setting a lower price, issuers can create a sense of urgency and demand, leading to a successful sale of the entire offering. In addition, underpricing can serve as a way to compensate investors for the risk they are taking on, providing them with a potential upside when the price rises once the securities begin trading on the secondary market. It can also help build a positive reputation for the company among investors, potentially leading to increased demand for future offerings. Understanding this concept is crucial for those involved in financial management, as it reflects strategic pricing decisions that influence both the initial investor reception and long-term investor relations.

9. What impact do stock dividends have on cash reserves?

- A. They increase cash reserves
- B. They do not affect cash reserves
- C. They decrease cash reserves**
- D. They lead to immediate liquidity issues

Stock dividends are a distribution of additional shares of a company's stock to its existing shareholders, rather than distributing cash. When a company issues stock dividends, it allocates shares from its retained earnings or reserves rather than from its cash balance. As a result, the company's cash reserves remain unaffected by issuing stock dividends. The correct understanding of stock dividends is that they do not involve any cash outflow, and therefore cannot decrease cash reserves. Instead, they only alter the composition of equity without impacting the liquidity of the company. The issuance of stock dividends can also be seen as a way for companies to reward shareholders without depleting cash reserves, thereby maintaining liquidity. In the context of the options provided, the second choice, which states that stock dividends do not affect cash reserves, accurately reflects the nature of stock dividends by indicating that cash reserves remain stable after their issuance. This understanding is key for financial management professionals in evaluating corporate actions and their implications for liquidity and shareholder equity.

10. What is referred to as "greenmail" in stock repurchases?

- A. Selling shares at a profit
- B. Buying off a hostile bidder at a premium**
- C. Distributing dividends instead of repurchasing
- D. Issuing new stock

"Greenmail" refers specifically to the practice of a company repurchasing its own shares from a hostile bidder at a premium price to prevent a takeover. This situation typically arises when an outside entity accumulates a significant number of shares in a company with the intention of gaining control. The target company, wanting to fend off this takeover attempt, offers to buy back the shares at a higher price than the market value, effectively 'buying off' the aggressor. This strategy allows the company to maintain its independence, albeit at a cost. In this context, buying off a hostile bidder is a strategic move often used by management to stabilize control over the company without engaging in a prolonged struggle or risking a change in governance. This maneuver is seen as controversial because it can use company resources to enrich shareholders who might have otherwise been willing to sell their stakes at fair market value.

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://accaadvancedfinancialmanagement-afm.examzify.com>

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