ACCA Advanced Financial Management (AFM) Practice Exam (Sample)

Study Guide

BY EXAMZIFY

Everything you need from our exam experts!

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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. 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.

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. 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!

Questions

1. **What is the primary purpose of firms raising funds?**
   - **A. To increase employee salaries**
   - **B. For capital investment and net working capital**
   - **C. To pay off existing debts**
   - **D. For mergers and acquisitions**

2. **What financial measure increases as a firm undertakes more debt?**
   - **A. Overall risk of the firm's operations**
   - **B. Value of equity per share**
   - **C. The variability of returns for shareholders**
   - **D. Firm's liquidity ratio**

3. **What is the main purpose of the record date in dividend distribution?**
   - **A. To track how many shares are outstanding**
   - **B. To identify which stockholders will receive dividends**
   - **C. To determine the payment method**
   - **D. To establish future stock prices**

4. **What is a Dutch auction in the context of stock repurchases?**
   - **A. A method of public offering**
   - **B. A process to buy back shares at the lowest possible price**
   - **C. A type of investor meeting**
   - **D. A cash dividend strategy**

5. **Which of the following statements about dividends is accurate?**
   - **A. Dividends are always paid in cash**
   - **B. Dividends can be declared at any time by management**
   - **C. Dividends can be fixed or variable**
   - **D. Dividends are solely dependent on market conditions**

6. What trend has been observed regarding firms' issuance of debt and equity since 1965?

A. More equity than debt is issued

B. Firms have issued only preferred stock

C. More debt than equity has been issued based on book values

D. The issuance of securities has remained stable

7. What characterizes secured debt?

A. It has first claim on specified collateral in the event of default

B. It is backed by government guarantees

C. It has higher interest rates than unsecured debt

D. It is only available to large corporations

8. What does an increase in debt usually imply for shareholder returns?

A. Stability in returns due to fixed costs

B. Decreased variability in returns

C. Increased variability in returns

D. Consistent returns irrespective of market changes

9. If dividends are taxed more heavily than capital gains, what will investors typically prefer?

A. High dividends over capital gains

B. Low dividends

C. Equal dividends and capital gains

D. High capital gains

10. Which of the following activities is typically performed by investment banks?

A. Only underwriting stocks

B. Advising on takeovers and managing portfolios

C. Directly investing in public companies

D. Offering savings accounts

Answers

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

Explanations

1. What is the primary purpose of firms raising funds?

A. To increase employee salaries

<u>B. For capital investment and net working capital</u>

C. To pay off existing debts

D. For mergers and acquisitions

The primary purpose of firms raising funds is primarily related to capital investment and net working capital. This involves acquiring the necessary resources to support the firm’s operational activities and to invest in long-term assets that contribute to the company’s growth and value generation. Capital investment typically refers to the funds raised to purchase physical assets such as buildings, machinery, and equipment, which are essential for production and service delivery. These investments are crucial for expansion, modernization, and maintaining competitiveness in the market. Net working capital, on the other hand, pertains to the funds necessary to cover day-to-day operational expenses. This includes working capital components such as inventory, accounts receivable, and accounts payable. Sufficient working capital ensures that a company can meet its short-term liabilities and continue its operations smoothly without facing liquidity issues. While other reasons for raising funds, such as paying off existing debts or financing mergers and acquisitions, may also be valid, they usually stem from the broader need to ensure that the firm has the necessary resources to operate effectively and grow in the market. Therefore, capital investment and net working capital are fundamental to a firm’s financial strategy and operational success.

2. What financial measure increases as a firm undertakes more debt?

A. Overall risk of the firm's operations

B. Value of equity per share

<u>C. The variability of returns for shareholders</u>

D. Firm's liquidity ratio

The financial measure that increases as a firm undertakes more debt is the variability of returns for shareholders. As a company takes on more debt, it amplifies the potential fluctuations in its earnings and cash flows, which directly impacts the returns that shareholders can expect to receive. This phenomenon occurs due to the fixed nature of interest obligations that the company must meet; when a company has a higher level of debt, any change in revenues can lead to a proportionally larger change in net income after interest expenses are deducted. In a scenario where a company is highly leveraged, even small variations in operating performance can result in significant swings in profitability, thus increasing the uncertainty of returns. This heightened risk is often reflected in higher volatility in the company's stock price, as investors react to the increased risk associated with the firm's financial structure. The other options do not accurately reflect the direct effect of increased debt on a firm. For instance, the overall risk of the firm's operations may increase, but it is not a financial measure in the same way as variability of returns. The value of equity per share may also decrease due to increased debt, as the equity becomes riskier and may trade at a lower price. Lastly, a firm’s liquidity ratio may decrease because higher debt levels can strain

3. What is the main purpose of the record date in dividend distribution?

A. To track how many shares are outstanding

B. To identify which stockholders will receive dividends

C. To determine the payment method

D. To establish future stock prices

The main purpose of the record date in dividend distribution is to identify which stockholders will receive dividends. The record date is set by the company's board of directors and marks the cutoff point for shareholders who will be entitled to receive the declared dividend. Stockholders who are on the company's books as of this date will receive the dividends, regardless of any transactions that happen after that date. This ensures that the company can accurately distribute dividends only to those who are officially recognized as shareholders at the time the dividend is declared, making it a critical date for dividend declarations. The other options do not accurately reflect the primary purpose of the record date. For instance, while it's important to know how many shares are outstanding, tracking outstanding shares is a separate function and does not directly relate to the record date's role in dividend distribution. Similarly, determining the payment method or establishing future stock prices are not functions of the record date; these concerns lie within broader corporate finance management and market dynamics.

4. What is a Dutch auction in the context of stock repurchases?

A. A method of public offering

B. A process to buy back shares at the lowest possible price

C. A type of investor meeting

D. A cash dividend strategy

In the context of stock repurchases, a Dutch auction is a method that allows a company to buy back its shares at the lowest possible price. During a Dutch auction, the company specifies a range of prices at which it is willing to repurchase shares. Shareholders then submit bids indicating the quantity of shares they are willing to sell at various prices within that range. The final purchase price is determined based on the lowest bid price at which the company can acquire the desired number of shares. This process is beneficial for the company as it allows for potentially lower acquisition costs since it pays the lowest price at which it can secure the necessary number of shares, thus resulting in efficient capital deployment. Moreover, it also provides flexibility and allows shareholders to express their valuation of the shares effectively. By encouraging competitive bidding, a Dutch auction can help identify the market's fair value for the shares being repurchased. In contrast, a method of public offering involves issuing new shares to raise capital, which does not relate to share buybacks. An investor meeting typically pertains to communications and discussions with shareholders but does not denote a mechanism for repurchasing shares. A cash dividend strategy is focused on distributing profits back to shareholders rather than reacquiring shares from the market.

5. Which of the following statements about dividends is accurate?

A. Dividends are always paid in cash

B. Dividends can be declared at any time by management

C. Dividends can be fixed or variable

D. Dividends are solely dependent on market conditions

Dividends can indeed be fixed or variable, which is why this statement is accurate. A fixed dividend is a set amount that a company decides to pay to shareholders, often seen in preferred shares. Imposing predictability, it allows shareholders to anticipate their returns. Conversely, variable dividends are more flexible and can be adjusted based on a company's financial performance and earnings. This variability reflects the company's current profit levels, allowing management some discretion in determining what they can afford to distribute to shareholders without undermining their operational needs. In contrast, dividends are not necessarily always paid in cash, which makes the first statement inaccurate; they can also be paid in the form of additional shares or property. The second statement about dividends being declared at any time by management overlooks the legal and financial obligations that a company must meet before declaring dividends. Finally, the declaration of dividends is not solely dependent on market conditions but is influenced by the company's internal financial performance, strategic objectives, and cash flow needs, rendering the last option less comprehensive.

6. What trend has been observed regarding firms' issuance of debt and equity since 1965?

A. More equity than debt is issued

B. Firms have issued only preferred stock

C. More debt than equity has been issued based on book values

D. The issuance of securities has remained stable

The trend observed in the issuance of debt and equity since 1965 indicates that firms have issued more debt than equity based on book values. This trend can be attributed to several factors, including the cost of capital considerations and tax advantages associated with debt financing. Historically, companies have found debt to be a cheaper source of capital compared to equity due to lower interest rates and the tax deductibility of interest expenses. This makes debt a more attractive option for financing projects and expansion. Additionally, firms may choose to avoid equity issuance to prevent dilution of ownership among existing shareholders. This shift towards favoring debt over equity can also be linked to broader economic conditions, regulatory changes, and market dynamics that influence a company's capital structure decisions. The increasing reliance on debt allows firms greater leverage, potentially leading to higher returns on equity, which can incentivize managers to pursue this financing option. The other options suggest alternative trends or circumstances that do not align with the evidence observed in the financial markets over the decades. For example, the claim that firms have only issued preferred stock does not hold true, as common equity and various forms of debt securities have remained prevalent. Similarly, the notion that the issuance of securities has remained stable overlooks the significant fluctuations in capital markets and the

7. What characterizes secured debt?

A. It has first claim on specified collateral in the event of default

B. It is backed by government guarantees

C. It has higher interest rates than unsecured debt

D. It is only available to large corporations

Secured debt is primarily characterized by its connection to specific collateral that can be claimed in the event of a default on the loan. This means that if the borrower fails to meet the repayment obligations, the lender has the right to seize the collateral to recover the outstanding amount. This arrangement reduces the lender's risk, as they have tangible assets that can offset potential losses, making this type of debt more secure than unsecured debt, which does not have collateral backing. The presence of collateral often leads to more favorable borrowing terms, including lower interest rates, as the risk to the lender is mitigated. This is why the assertion about first claim on specified collateral accurately captures the essence of secured debt. Other choices do not fully encapsulate the fundamental characteristics of secured debt. While government guarantees can enhance security, they do not define secured debt itself. Higher interest rates are typically associated with unsecured debt due to the greater risk involved for lenders. Availability to large corporations is not exclusive, as individuals and smaller businesses can also access secured loans.

8. What does an increase in debt usually imply for shareholder returns?

A. Stability in returns due to fixed costs

B. Decreased variability in returns

C. Increased variability in returns

D. Consistent returns irrespective of market changes

An increase in debt typically implies that a company is leveraging itself more, which can lead to increased variability in shareholder returns. This occurs because debt financing introduces fixed interest payments that must be paid regardless of the company's performance. If the company experiences higher profits, the returns for shareholders can be significantly magnified; however, if the company's performance declines, the impact on returns can also be more severe. The leverage effect means that while debt can amplify gains when the company's revenue is strong, it also increases the risk during downturns, resulting in greater fluctuations in returns. This volatility is a critical consideration for shareholders, who may face the potential for both higher returns and significant losses depending on the company's operational performance. In contrast, the other options suggest a level of stability or consistency in returns associated with increased debt, which does not accurately capture the risk-return trade-off inherent in using leverage in corporate finance. Therefore, the correct answer reflects the true nature of increased debt influencing shareholder returns through heightened variability.

9. If dividends are taxed more heavily than capital gains, what will investors typically prefer?

A. High dividends over capital gains

B. Low dividends

C. Equal dividends and capital gains

D. High capital gains

When dividends are taxed more heavily than capital gains, investors typically prefer low dividends. This preference arises because higher taxation on dividends means that after-tax income from dividends is reduced, making them less attractive compared to capital gains, which are usually taxed at a lower rate. Investors focus on maximizing their after-tax returns. When dividends are subject to greater tax liabilities, they may favor strategies that emphasize capital gains, which provide a more favorable tax treatment. By opting for low dividends, investors can keep more capital invested, allowing for potential appreciation and deferred tax liabilities until they ultimately realize those gains. This tax structure incentivizes companies to retain earnings or prioritize share buybacks rather than issuing high dividends. As a result, investors looking to optimize their after-tax returns would indeed prefer lower dividends in this scenario.

10. Which of the following activities is typically performed by investment banks?

A. Only underwriting stocks

B. Advising on takeovers and managing portfolios

C. Directly investing in public companies

D. Offering savings accounts

Investment banks are primarily known for their role in providing a variety of financial services, and advising on takeovers and managing portfolios is a key component of their operations. They offer expertise in mergers and acquisitions, guiding companies through the complexities of these transactions, which often involve negotiations, valuations, and regulatory considerations. Furthermore, investment banks manage portfolios for institutional clients, employing strategies that align with the clients' investment objectives and risk appetites. The combination of advisory services in corporate finance and portfolio management exemplifies the advisory and strategic role of investment banks in the financial markets, highlighting their importance beyond simple transactions. This delineates the fundamental nature of investment banking, centered on complex financial transactions and providing strategic advice rather than retail banking activities or simplistic underwriting. The other options do not accurately capture the breadth of activities typically undertaken by investment banks. Underwriting stocks, while a function of investment banks, does not encompass their full spectrum of activities. Directly investing in public companies can often fall into the realm of private equity or institutional investment rather than core investment banking services. Offering savings accounts is characteristic of commercial banks rather than investment banks, which focus on capital markets and corporate finance. Thus, the activities of advising on takeovers and managing portfolios correctly represent the essential services provided by

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!