

ACCA ADVANCED FINANCIAL MANAGEMENT (AFM) PRACTICE EXAM (SAMPLE) STUDY GUIDE



SAMPLE STUDY GUIDE WITH LIMITED QUESTIONS

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THE FULL VERSION STUDY GUIDE

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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

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- 1. What is the purpose of bond ratings?**
 - A. To determine the investment value of the bonds
 - B. To assist investors in assessing default risk
 - C. To set interest rates for bonds
 - D. To indicate market demand for bonds
- 2. 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
- 3. How do commercial banks primarily obtain money from deposits?**
 - A. By borrowing from other banks
 - B. By selling debt and common stock to investors
 - C. Through government grants
 - D. By issuing corporate bonds
- 4. Why might companies choose to implement stock splits?**
 - A. To eliminate shareholders
 - B. To keep the stock price in an optimal range
 - C. To increase cash reserves
 - D. To signal stock buybacks
- 5. Which of the following best describes a major reason firms opt for stock buybacks?**
 - A. To replace equity with debt
 - B. To favor employee stock options
 - C. To enhance brand reputation
 - D. To engage in aggressive marketing
- 6. What is true regarding the combination and splitting of assets?**
 - A. It will always affect the asset value
 - B. It does not affect value as long as it does not affect investor choice
 - C. It guarantees an increase in the total value
 - D. It is irrelevant in all contexts

- 7. What services do financial institutions collectively provide?**
- A. Only investment advisory services
 - B. Payment services, borrowing and lending, pooling risks
 - C. Insurance and real estate management
 - D. Property management and marketing services
- 8. What does a dividend reinvestment plan (DRIP) allow shareholders to do?**
- A. Withdraw their dividends as cash
 - B. Reinvest dividends in shares of the company stock
 - C. Convert dividends into bonds
 - D. Sell dividends on the market
- 9. Under what condition should a firm ideally make payouts to investors?**
- A. When total capital exceeds earnings
 - B. When generating Free Cash Flow (FCF) and a positive NPV
 - C. When the market demand is high
 - D. When profit margins reach a historical high
- 10. What is considered the optimal price range for a stock?**
- A. \$10-\$40
 - B. \$20-\$80
 - C. \$50-\$100
 - D. \$75-\$150

Answers

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

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Explanations

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1. What is the purpose of bond ratings?

- A. To determine the investment value of the bonds
- B. To assist investors in assessing default risk**
- C. To set interest rates for bonds
- D. To indicate market demand for bonds

Bond ratings serve a crucial role in the financial markets by providing an assessment of the default risk associated with a bond issuer. The primary purpose of these ratings is to give investors a clear indication of the likelihood that the issuer will default on its debt obligations, which means failing to make the required interest payments or repay the principal amount upon maturity. When investors evaluate bonds, they are particularly concerned about the safety of their investment and the consistency of returns. High-quality ratings suggest a lower risk of default, making such bonds a safer investment choice, often attracting risk-averse investors. Conversely, lower-rated bonds indicate higher risk, which may yield higher returns to compensate for the increased chance of default. This system of rated classifications aids investors in making informed decisions by comparing the relative risk levels of different bonds, thereby enhancing transparency in the bond market. The other options, while related to bond investing, do not capture the core function of bond ratings as effectively. For instance, determining the investment value of the bonds or setting interest rates pertains more to broader market dynamics and investor perceptions rather than the specific purpose of ratings. Indicating market demand relates to how well a bond might sell in the market but does not directly address the risk of default, which is central to

2. 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.

3. How do commercial banks primarily obtain money from deposits?

- A. By borrowing from other banks
- B. By selling debt and common stock to investors**
- C. Through government grants
- D. By issuing corporate bonds

Commercial banks primarily obtain funds from deposits by attracting customers to open various types of accounts, such as checking accounts, savings accounts, and time deposits. When individuals and businesses deposit money into these accounts, the banks gain access to this pool of funds, which they can then use to provide loans, invest in securities, or meet other liabilities. The option related to selling debt and common stock to investors pertains to how banks might raise additional capital, but it does not directly reflect the primary means of obtaining money through deposits. Loans and investments, funded by customer deposits, play a crucial role in the overall functioning of a bank and its ability to make profits. Other options like borrowing from other banks, receiving government grants, or issuing corporate bonds are more about supplementary funding or financial strategies rather than the foundational activity of accepting deposits, which forms the core of a bank's funding model. Thus, the reliance on deposit-taking is fundamental to their operations, making it the most accurate reflection of how commercial banks primarily gather money.

4. Why might companies choose to implement stock splits?

- A. To eliminate shareholders
- B. To keep the stock price in an optimal range**
- C. To increase cash reserves
- D. To signal stock buybacks

Companies often implement stock splits primarily to keep the stock price in an optimal range. When the share price becomes too high, it can limit the ability of smaller investors to purchase shares, potentially decreasing liquidity and market interest in the stock. By splitting the stock, the company lowers the per-share price while maintaining the overall market capitalization. This action can make the shares more affordable and accessible to a broader range of investors, which can lead to increased trading volume and interest in the stock. As a result, it can enhance market liquidity and potentially contribute to a more stable trading environment. Opting for stock splits can be part of a broader strategy to maintain market attractiveness without changing the fundamental value of the company.

5. Which of the following best describes a major reason firms opt for stock buybacks?

- A. To replace equity with debt**
- B. To favor employee stock options
- C. To enhance brand reputation
- D. To engage in aggressive marketing

Firms often opt for stock buybacks primarily to replace equity with debt as a strategic financial maneuver. This is known as leveraging, where the company reduces the proportion of equity in its capital structure by buying back shares and, in many cases, subsequently taking on debt. This can lead to a higher return on equity (ROE) since the same amount of earnings will now be distributed to a smaller equity base. Furthermore, by replacing equity with debt, companies might also benefit from tax advantages as interest on debt is generally tax-deductible, potentially leading to increased overall firm value. While replacing equity with debt is a significant motivation, companies can engage in buybacks for other reasons, such as benefiting employees through stock options, enhancing perceived brand reputation, or allowing for aggressive marketing strategies. However, these factors are generally secondary to the overarching financial strategy of capital structure management through buybacks.

6. What is true regarding the combination and splitting of assets?

- A. It will always affect the asset value
- B. It does not affect value as long as it does not affect investor choice**
- C. It guarantees an increase in the total value
- D. It is irrelevant in all contexts

When considering the combination and splitting of assets in the context of financial management, the correct understanding hinges on how these actions impact investor choices and perceptions rather than the intrinsic value of the assets themselves. Combining or splitting assets—often referred to in finance as consolidation or division—can influence how investors perceive these assets. However, as long as these actions do not change the actual valuation of the cash flows generated by those assets or the risk associated with them, the overall value to the firm does not necessarily change. This perspective is based on the notion that value is linked to the cash flows and the risk profile rather than the specific arrangement of the assets. Investor behavior plays a critical role in this context. Splitting shares might make them more accessible to small investors, potentially increasing demand, but it does not inherently alter the company's fundamental value. Similarly, combining assets into a single entity could streamline operations and appeal to certain investors, but it again does not change the underlying worth as long as it does not alter investor choice. Option A, suggesting that it will always affect the asset value, lacks nuance, as the effects depend on how investors perceive the arrangement rather than a direct change in value. Option C implies a guaranteed increase which is not accurate because mere restructuring

7. What services do financial institutions collectively provide?

- A. Only investment advisory services
- B. Payment services, borrowing and lending, pooling risks**
- C. Insurance and real estate management
- D. Property management and marketing services

Financial institutions play a crucial role in the economy by offering a wide range of services that cater to individual and business needs. The correct answer highlights several key functions carried out by these institutions: payment services, borrowing and lending, and pooling risks. Payment services refer to the facilitation of transactions between individuals and businesses, allowing for smooth exchanges of goods and services. This includes electronic funds transfers, credit and debit card services, and other mechanisms that enable efficient payment systems. Borrowing and lending are fundamental to the operation of financial institutions. They collect deposits from savers and use these funds to provide loans to individuals and businesses, which helps stimulate economic activity and supports consumption and investment. Pooling risks is another critical service offered by financial institutions, particularly in the insurance sector. This involves gathering a large number of policyholders to spread out the risk of loss, making individual contributions more manageable and ensuring that individuals are protected against significant financial hardships. These collective services provided by financial institutions not only support the functioning of the financial markets but also enhance economic stability and growth. The other choices do not encompass the breadth of services offered by financial institutions, as they either focus on specific areas or fail to capture the comprehensive nature of the functions performed by these entities.

8. What does a dividend reinvestment plan (DRIP) allow shareholders to do?

- A. Withdraw their dividends as cash
- B. Reinvest dividends in shares of the company stock**
- C. Convert dividends into bonds
- D. Sell dividends on the market

A dividend reinvestment plan (DRIP) is a program that enables shareholders to use the cash dividends they earn from their shares to purchase additional shares of the company's stock, rather than receiving the dividends in cash. This approach not only helps shareholders to accumulate more shares over time, potentially increasing their investment's value due to compounding but also supports the company by providing it with reinvested capital. When shareholders participate in a DRIP, they typically buy shares at a discounted price or without paying any brokerage fees, which adds additional value to their investment. This practice is particularly enticing for long-term investors who believe in the company's growth potential and aim to increase their ownership stake without incurring additional cash outflows. The other options do not accurately describe the primary function of a DRIP, making the correct answer distinctly focused on reinvesting dividends in shares of the company stock.

9. Under what condition should a firm ideally make payouts to investors?

- A. When total capital exceeds earnings
- B. When generating Free Cash Flow (FCF) and a positive NPV**
- C. When the market demand is high
- D. When profit margins reach a historical high

The ideal condition for a firm to make payouts to investors, such as dividends or share buybacks, is when it is generating Free Cash Flow (FCF) and has a positive Net Present Value (NPV) on its investment projects. Free Cash Flow is a key indicator of a company's financial health and represents the cash that is available to investors after all operating expenses and capital expenditures have been accounted for. When a company has strong FCF, it indicates that it has sufficient cash flows to not only reinvest in its core operations but also return surplus cash to shareholders without compromising future growth opportunities. Additionally, a positive NPV implies that the company's potential investment opportunities are expected to generate returns greater than the cost of the capital used to finance them, suggesting effective capital allocation. If a firm has both healthy FCF and positive NPV projects, it signals that it can afford to reward its investors while sustaining and possibly growing its operations. In contrast, relying on other conditions, such as total capital exceeding earnings, high market demand, or peak profit margins, does not necessarily reflect a sustainable or prudent payout strategy. These factors may indicate temporary financial performance but do not guarantee the long-term stability needed for consistent payouts.

10. What is considered the optimal price range for a stock?

- A. \$10-\$40
- B. \$20-\$80**
- C. \$50-\$100
- D. \$75-\$150

The optimal price range for a stock is often assessed based on various factors including investor psychology, liquidity, and market perception. A price range of \$20-\$80 is generally considered favorable as it balances accessibility for retail investors while still providing enough value perception for institutional investors. Stocks priced above \$80 may limit buying interest for smaller investors who often engage in bulk purchases for diversification but may hesitate when individual stock prices climb too high. Conversely, stocks in the lower price brackets, such as under \$20, may be perceived as having lower quality or less potential for growth, which can deter serious investment interest. In this context, a price range of \$20-\$80 offers a level of affordability that can attract a broad base of investors, combined with the potential for future capital appreciation. This range aligns with the types of companies that typically appeal to a wide audience, including those in growth phases or sectors deemed promising. Consequently, it creates a more favorable environment for trading and investment as it aligns with expectations and behaviors observed in the market.

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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:

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

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