

Accredited Financial Counselor (AFC) Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

- 1. Which of the following best describes 'opportunity cost'?**
 - A. The monetary cost of the chosen option**
 - B. The benefits missed from the next best alternative**
 - C. The overall expense incurred in a transaction**
 - D. The total income generated from an investment**
- 2. What term describes lending that is specifically designed for borrowers with low credit scores?**
 - A. High-risk lending**
 - B. Subprime lending**
 - C. Conventional lending**
 - D. Personal loans**
- 3. A client is struggling to meet their monthly bills and has an \$8,000 tax refund. Which form should be adjusted to avoid this in the future?**
 - A. W-2**
 - B. W-4**
 - C. 1099**
 - D. Schedule C**
- 4. What is the purpose of a revolving savings fund?**
 - A. To accumulate funds for retirement only**
 - B. To cover everyday expenses**
 - C. Both accumulate funds for large, irregular expenses and meet occasional deficits**
 - D. To invest in stocks and bonds**
- 5. Which of the following is an example of a process goal?**
 - A. I will put 10% of every paycheck into savings.**
 - B. I will arrange my office in ways that will help my client lower their stress level.**
 - C. I will track my spending for two months.**
 - D. I will download budgeting software.**

- 6. Mortgage insurance primarily protects whom?**
- A. The borrower**
 - B. The lender**
 - C. The insurer**
 - D. The government**
- 7. What is the primary purpose of setting long-term financial goals?**
- A. To increase savings**
 - B. To provide direction for overall financial planning**
 - C. To maximize investment returns**
 - D. To avoid debt**
- 8. What does "asset allocation" involve?**
- A. Choosing a single investment option**
 - B. Spreading investments across different asset categories**
 - C. Investing solely in real estate**
 - D. Maximizing cash holdings only**
- 9. For which of the following scenarios could a borrower get tax-free forgiveness?**
- A. Bankruptcy**
 - B. Total disability, death, and public service loan forgiveness**
 - C. ICR forgiveness and closed school cancellation**
 - D. REPAYE forgiveness only**
- 10. What document serves as a formal record of an individual's financial activities?**
- A. A financial statement**
 - B. A credit report**
 - C. A tax return**
 - D. A budget plan**

Answers

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

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Explanations

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1. Which of the following best describes 'opportunity cost'?

- A. The monetary cost of the chosen option**
- B. The benefits missed from the next best alternative**
- C. The overall expense incurred in a transaction**
- D. The total income generated from an investment**

Opportunity cost is best defined as the benefits missed from the next best alternative, which captures the essence of making a choice in the context of limited resources. When you make a decision to choose one option over another, opportunity cost represents the value of the foregone alternative that you did not select. This concept is fundamental in economics and personal finance, as it helps individuals and businesses evaluate the true cost of their decisions by considering not only the explicit monetary costs but also the potential gains they sacrifice in choosing one path over another. In this scenario, defining opportunity cost solely in terms of monetary cost, transaction expense, or total income from an investment misses the broader perspective that encompasses the value of what is given up in pursuing a particular choice. It's essential for individuals to understand opportunity cost when making financial decisions, as it can influence budgeting, investing, and overall resource allocation to ensure they make choices aligned with their goals and maximize their utilities.

2. What term describes lending that is specifically designed for borrowers with low credit scores?

- A. High-risk lending**
- B. Subprime lending**
- C. Conventional lending**
- D. Personal loans**

Subprime lending is the term that specifically describes lending aimed at borrowers with low credit scores. This type of lending recognizes that individuals with lower credit ratings may have had financial difficulties in the past but still need access to credit. Subprime loans typically come with higher interest rates compared to prime loans, reflecting the greater risk associated with lending to borrowers who may not qualify for more favorable terms due to their credit history. In contrast, high-risk lending can be a broader category that may include various types of loans deemed risky but does not specifically focus on low credit scores. Conventional lending generally refers to loans that conform to standard criteria set by financial institutions and government-backed entities, which usually favor borrowers with strong credit histories. Personal loans encompass a wider range of lending options that may not specifically target the needs of borrowers with low credit scores, as they can also be available to those with good credit. Thus, subprime lending uniquely identifies the structured approach to accommodate those facing challenges related to their creditworthiness.

3. A client is struggling to meet their monthly bills and has an \$8,000 tax refund. Which form should be adjusted to avoid this in the future?

A. W-2

B. W-4

C. 1099

D. Schedule C

Adjusting the W-4 form is essential for clients who find themselves receiving a significant tax refund while struggling to meet their monthly expenses. The W-4 form, which is the Employee's Withholding Certificate, allows employees to inform their employer of the amount of federal income tax to withhold from their paychecks. When employees get large tax refunds, it often indicates that too much money has been withheld from their paychecks throughout the year. While receiving a refund might seem beneficial, it essentially means that the taxpayer has lent the government money without interest for a year, money that could have been used to cover immediate expenses or savings goals. By adjusting the W-4 to decrease withholding, the client can increase their take-home pay, which can help alleviate their monthly financial pressures. This change allows them to keep more of their earnings throughout the year instead of waiting for a refund that may not ultimately help them in managing their immediate financial needs. The other forms, such as the W-2 (which reports annual wages and tax withheld), 1099 (which reports various types of income other than wages), and Schedule C (related to business income), do not directly manage the withholding process that affects the client's monthly budget in the same way.

4. What is the purpose of a revolving savings fund?

A. To accumulate funds for retirement only

B. To cover everyday expenses

C. Both accumulate funds for large, irregular expenses and meet occasional deficits

D. To invest in stocks and bonds

The purpose of a revolving savings fund is primarily to facilitate financial flexibility by allowing individuals to accumulate funds for large, irregular expenses while also providing a buffer to meet occasional deficits. This type of fund is designed to be accessed and replenished, enabling savers to draw on it in times of need, such as unexpected medical bills or major purchases that don't occur regularly. The key feature of a revolving savings fund is its adaptability; once money is withdrawn for an unforeseen expense, it can be replenished over time through regular savings contributions. This structure is particularly beneficial for managing budgetary overflow and ensuring financial stability amid fluctuating income or expenses. In contrast to options that specify rigid purposes, such as accumulating funds solely for retirement or investing in stocks and bonds, the revolving savings fund focuses on providing versatility in managing both anticipated and unanticipated financial needs. It serves as a crucial tool for individuals looking to balance their savings for significant irregular expenses while also ensuring they can manage their regular living costs without undue stress.

5. Which of the following is an example of a process goal?

- A. I will put 10% of every paycheck into savings.**
- B. I will arrange my office in ways that will help my client lower their stress level.**
- C. I will track my spending for two months.**
- D. I will download budgeting software.**

The identification of an example of a process goal can be understood by examining the nature of the listed options. A process goal focuses on the actions, methods, or strategies that lead towards achieving a larger outcome or objective. In this regard, arranging the office in ways that contribute to lowering the client's stress level represents a process goal because it involves a specific action taken to facilitate a desired emotional state for clients. This process emphasizes changing the environment as a means of promoting better outcomes, showing a commitment to behavioral changes and practices that enhance client experiences. Other choices, while they may reflect commitments or objectives, are more oriented towards tangible outcomes or results rather than the methods or processes involved in reaching those outcomes. For instance, putting a specific percentage of a paycheck into savings is about the end result of saving money, and tracking spending or downloading software are actions, but they are less facilitative of a broader process aimed explicitly at improving a client experience or managing stress.

6. Mortgage insurance primarily protects whom?

- A. The borrower**
- B. The lender**
- C. The insurer**
- D. The government**

Mortgage insurance primarily protects the lender. This insurance is typically required when a borrower does not make a sizable down payment on a home, often less than 20% of the purchase price. The purpose of mortgage insurance is to mitigate the risk for lenders in case the borrower defaults on the loan. In the event of default, the mortgage insurance will cover a portion of the lender's losses. This protection allows lenders to offer loans to borrowers who may not have the substantial upfront capital typically required, thus enabling more individuals to purchase homes. Other options do not accurately describe the primary beneficiary of mortgage insurance. For example, while borrowers may benefit indirectly from the availability of loans that require less down payment, they are not the primary party that mortgage insurance protects. Similarly, the insurer and the government do not receive the primary protection; rather, their roles vary in the context of the mortgage market, with the insurer being a provider of the coverage and the government potentially backing certain programs but not being directly protected by individual mortgage insurance policies.

7. What is the primary purpose of setting long-term financial goals?

- A. To increase savings**
- B. To provide direction for overall financial planning**
- C. To maximize investment returns**
- D. To avoid debt**

The primary purpose of setting long-term financial goals is to provide direction for overall financial planning. When individuals establish long-term goals, they create a clear vision of what they want to achieve with their finances over a substantial period. This clarity helps in developing a strategic plan that aligns their financial behavior and decisions with their aspirations, such as retirement, buying a home, or funding education. Long-term goals act as a guiding framework, allowing individuals to make informed choices about saving, investing, and managing expenses. They also help prioritize short-term actions and measure progress towards achieving these larger objectives. While setting goals may indeed lead to increased savings, maximizing investment returns, or avoiding debt, these are more specific outcomes that flow from having clear, long-term financial goals in place. Therefore, the overarching benefit of goal setting is its role in steering the individual's overall financial strategy.

8. What does "asset allocation" involve?

- A. Choosing a single investment option**
- B. Spreading investments across different asset categories**
- C. Investing solely in real estate**
- D. Maximizing cash holdings only**

Asset allocation involves spreading investments across different asset categories, such as stocks, bonds, and cash equivalents. This strategy is designed to balance risk and reward in an investment portfolio. By diversifying investments across various asset classes, investors aim to reduce the impact of poor performance from a single investment or market sector. This diversification helps to safeguard the overall investment by providing exposure to different areas of the market that may perform differently under varying economic conditions. The focus on asset allocation is based on the understanding that different asset classes have unique risk and return characteristics. For example, while stocks may offer potential for high returns, they also come with higher volatility. Conversely, bonds typically provide more stability but lower returns. By combining these different asset types, investors can create a portfolio that aligns with their financial goals, risk tolerance, and time horizon. Choosing a single investment option would not reflect asset allocation principles since it lacks diversification. Similarly, investing solely in real estate limits exposure to other potentially lucrative asset classes. Focusing exclusively on maximizing cash holdings ignores the opportunity for growth that other investments can provide and does not align with the principles of diversification and risk management inherent in effective asset allocation strategies.

9. For which of the following scenarios could a borrower get tax-free forgiveness?

A. Bankruptcy

B. Total disability, death, and public service loan forgiveness

C. ICR forgiveness and closed school cancellation

D. REPAYE forgiveness only

Tax-free forgiveness applies in several specific situations where certain conditions are met. The scenario that includes total disability, death, and public service loan forgiveness qualifies for tax-free forgiveness due to federal regulations in place designed to relieve borrowers from the burden of student loans under these extreme circumstances. Under the Public Service Loan Forgiveness (PSLF) program, borrowers who work in qualifying public service jobs after making 120 qualified payments can have their remaining loan balance forgiven without facing a tax liability. Total disability and death discharges also allow borrowers to eliminate their student loans without any tax implications. This is in contrast to other forms of forgiveness where the forgiven amount may be considered taxable income, leading to tax liabilities for the borrower. In situations involving bankruptcy, certain conditions apply, but generally, the process does not result in tax-free discharge. Options involving Income-Contingent Repayment (ICR) forgiveness or closed school cancellation may also lead to forgiveness, but they might not guarantee a tax-free status. Only specific programs and situations, such as those listed in option B, consistently provide this benefit.

10. What document serves as a formal record of an individual's financial activities?

A. A financial statement

B. A credit report

C. A tax return

D. A budget plan

A financial statement serves as a formal record of an individual's financial activities, providing a comprehensive overview of their financial position. This document typically includes key components such as income, expenses, assets, and liabilities, allowing for a clear assessment of an individual's financial health. By presenting data in a structured format, financial statements help individuals and financial counselors understand spending patterns, track progress towards financial goals, and make informed decisions regarding budgeting and saving. While other documents like credit reports, tax returns, and budget plans are relevant to one's finances, they serve different purposes. A credit report details an individual's credit history and outstanding debts, which can influence lending decisions. A tax return reflects a summary of income, deductions, and tax obligations for a specific year, while a budget plan outlines a strategy for managing future expenses and income. However, none of them cumulatively document ongoing financial activities like a financial statement.