ACCA FM Financial Management

Mock exam: 15 questions in 27 minutes, with an answer key and explanations

How to use this mock

- Set a timer for **27 minutes** and answer every question without notes. Write your answers in the grid on the next page.
- Mark your answers using the answer key, then read the explanation for every question you got wrong or guessed.
- The questions cover every section of the syllabus, in proportion to the GoQualified question bank for FM.
- Prefer to sit it on screen? The **Exam Sim** on **goqualified.co.uk/fm/** times you, marks the paper and shows your weakest section.
- All questions are original GoQualified practice questions, not past exam questions.

Free from GoQualified. Questions start on page 3; the answer key and explanations follow them. Download the latest version from goqualified.co.uk/fm/.

Your answers

1 _____	**4** _____	**7** _____	**10** _____	**13** _____
2 _____	**5** _____	**8** _____	**11** _____	**14** _____
3 _____	**6** _____	**9** _____	**12** _____	**15** _____

Questions

Question 1

Which statement best describes the relationship between financial objectives and corporate strategy?

A Financial objectives are set independently of corporate strategy and rarely influence it
B Corporate strategy is determined solely by the finance department, with no input from other functions
C Financial objectives should support and flow from the overall corporate objectives and strategy of the organisation
D Financial objectives only become relevant once the company is in financial difficulty

Question 2

Codes of corporate governance best practice typically recommend which of the following?

A Combining the roles of chairman and chief executive in one person
B Removing all non-executive directors from the board to speed up decisions
C Separating the roles of chairman and chief executive, and appointing independent non-executive directors
D Allowing executive directors to set their own remuneration without review

Question 3

What role do banks and other financial institutions play in the operation of the money markets?

A They set the national rate of inflation through central bank policy decisions
B They act as key participants and intermediaries, lending to and borrowing from one another to manage short-term liquidity
C They prepare the government's annual budget
D They are legally prohibited from participating in the money markets

Question 4

A company has an inventory holding period of 60 days, a receivables collection period of 45 days and a payables payment period of 35 days. What is its cash operating cycle?

A 140 days
B 50 days
C 20 days
D 70 days

Question 5

A company has trade receivables of £150,000 and credit sales of £1,095,000. What is its receivables collection period?

A 7.3 days
B 73 days
C 40 days
D 50 days

Question 6

The three motives traditionally used to explain why a company holds cash are the:

A Profit, growth and survival motives
B Short-term, medium-term and long-term motives
C Transactions, precautionary and speculative motives
D Equity, debt and dividend motives

Question 7

A project has an internal rate of return (IRR) of 15.7% and the company's cost of capital is 10%. What does this indicate?

A The project should be rejected because the IRR is positive
B The IRR represents the rate of inflation expected over the project's life
C The project only breaks even if its cash flows double
D The project should be accepted because its IRR exceeds the cost of capital

Question 8

Which of the following is a limitation of using expected values for a one-off investment decision?

A The expected value is an average that may never actually occur, and it ignores the decision-maker's attitude to risk
B Expected values cannot be calculated when the probabilities are known
C Expected values always overstate the true return achievable on a project
D Expected values can only be used by not-for-profit organisations

Question 9

A project has an expected NPV of +£40,000, but there is a 0.25 probability of a negative NPV of −£60,000. For a risk-averse decision-maker, what does this add beyond the expected NPV alone?

A Nothing at all — only the single expected NPV figure is ever relevant to the decision
B It highlights the downside risk (a one-in-four chance of a loss), which a risk-averse investor weighs alongside the positive expected value
C It proves the project must always be accepted
D It proves the project must always be rejected

Question 10

Which statement best contrasts a bank overdraft with a bank term loan?

A An overdraft is always cheaper than a term loan
B A term loan is repayable on demand, whereas an overdraft has a fixed repayment schedule
C Both are identical forms of long-term finance
D An overdraft is a flexible, repayable-on-demand facility for short-term needs; a term loan provides a fixed sum repaid over an agreed longer-term period

Question 11

A company retains 40% of its earnings and earns a return of 15% on reinvested funds. Using the earnings-retention (Gordon's growth) model, what is the expected dividend growth rate?

A 15%
B 6%
C 40%
D 55%

Question 12

A company is financed by equity with a market value of £6 million and a cost of 12%, and by debt with a market value of £4 million and an after-tax cost of 7%. What is its weighted average cost of capital (WACC)?

A 10.0%
B 9.5%
C 10.5%
D 19.0%

Question 13

A company's next dividend (D1) will be 21p per share. Dividends are expected to grow at 5% per year and shareholders require a return of 12%. Using the dividend growth model, what is the value per share?

A £1.75
B £1.24
C £4.20
D £3.00

Question 14

What is a key limitation of the net asset (asset-based) method of valuing a business?

A It is impossible to calculate for any company without audited financial statements
B It values the separable net assets but ignores the company's ability to generate future earnings and any internally generated goodwill
C It always produces a higher value than earnings-based methods
D It can only be used for not-for-profit organisations

Question 15

Which statement about interest rate options is correct?

A They oblige the buyer to borrow at the agreed rate whatever happens
B They are available only to banks and other large financial institutions
C They give the holder the right, but not the obligation, to deal at a set interest rate, protecting against adverse moves while allowing benefit from favourable ones
D They remove the need to pay any interest at all

Answer key

1 C	**4** D	**7** D	**10** D	**13** D
2 C	**5** D	**8** A	**11** B	**14** B
3 B	**6** C	**9** B	**12** A	**15** C

Score: count your correct answers out of 15. Then work through the explanations below.

Answers and explanations

Question 1: C Financial objectives should support and flow from the overall corporate objectives and strategy of the organisation

Financial objectives (such as a target return on capital, gearing level or dividend policy) should be derived from, and support, the wider corporate objectives and strategy — they translate strategic aims into measurable financial targets. Option A wrongly isolates them from strategy, option B overstates the finance function's role (strategy is set by the whole board), and option D is incorrect because financial objectives guide a healthy business continuously, not only in distress.

Section A, Financial objectives and corporate strategy · Ref A2a · fm005

Question 2: C Separating the roles of chairman and chief executive, and appointing independent non-executive directors

Corporate governance codes aim to reduce the agency problem by strengthening board oversight. Key recommendations include separating the chairman and chief-executive roles (so power is not concentrated in one individual) and appointing independent non-executive directors to provide objective challenge and to sit on audit and remuneration committees. Options A and D concentrate power and create conflicts of interest, and option B removes the very independence that governance codes seek to introduce.

Section A, Corporate governance · Ref A3e · fm010

Question 3: B They act as key participants and intermediaries, lending to and borrowing from one another to manage short-term liquidity

Banks are central to the money markets: they lend to and borrow from each other (the interbank market), issue and trade short-term instruments, and use the markets to manage their own day-to-day liquidity. Option A relates to macroeconomic policy set by the central bank and government, option C is a government function, and option D is the opposite of reality — banks are the principal participants.

Section B, Role of banks in the money markets · Ref B3b · fm030

Question 4: D 70 days

Cash operating cycle = inventory days + receivables collection period − payables payment period = 60 + 45 − 35 = 70 days. Option A (140) adds all three components, forgetting that the payables period is deducted. Option B (50) wrongly deducts the receivables period as well. Option C (20) mishandles the signs. The payables period is subtracted because credit taken from suppliers finances part of the cycle, reducing the cash the business itself must tie up.

Section C, Cash operating cycle — calculation · Ref C2a · fm038

Question 5: D 50 days

Receivables collection period = (trade receivables ÷ credit sales) × 365 = (£150,000 ÷ £1,095,000) × 365 = 50.0 days. Option A inverts the ratio (giving the receivables turnover of 7.3 times, not a number of days), option B (73) also misplaces the decimal point, and option C does not follow from the figures. This ratio shows how long, on average, customers take to pay; a rising figure can indicate weakening credit control or customers experiencing financial difficulty.

Section C, Receivables collection period · Ref C2b · fm042

Question 6: C Transactions, precautionary and speculative motives

The three classic motives for holding cash are the transactions motive (to meet routine day-to-day payments), the precautionary motive (a buffer against unexpected cash needs) and the speculative motive (to be able to exploit opportunities such as bargain purchases or attractive short-term investments). The other options list unrelated business concepts. Understanding why cash is held underpins the cash-management models, such as Baumol and Miller-Orr, used to set optimal balances.

Section C, Motives for holding cash · Ref C2f · fm057

Question 7: D The project should be accepted because its IRR exceeds the cost of capital

The IRR is the discount rate at which a project's NPV is zero. A project is acceptable when its IRR is greater than the cost of capital, because that implies a positive NPV at the company's actual cost of capital. Here 15.7% exceeds 10%, so the project should be accepted. Option A misstates the decision rule, while options B and C misdescribe what the IRR represents. For independent projects, the IRR and NPV rules give the same accept/reject decision.

Section D, IRR interpretation · Ref D1f · fm070

Question 8: A The expected value is an average that may never actually occur, and it ignores the decision-maker's attitude to risk

An expected value is a probability-weighted average that is most meaningful when a decision is repeated many times; for a one-off project the actual result may differ greatly from the average, which itself may not even be a possible outcome. It also conceals the spread of outcomes and ignores the decision-maker's risk attitude. Option B is wrong (probabilities are exactly what the method needs), and options C and D are simply untrue.

Section D, Expected values — limitations · Ref D3c · fm083

Question 9: B It highlights the downside risk (a one-in-four chance of a loss), which a risk-averse investor weighs alongside the positive expected value

The expected NPV summarises the average outcome but hides the spread. Knowing there is a 25% chance of a £60,000 loss reveals the downside risk, which a risk-averse decision-maker considers alongside the positive expected value before deciding. Option A ignores risk attitude, while options C and D treat a single statistic as decisive when it is the trade-off between expected return and risk that actually matters.

Section D, Probability and downside risk · Ref D3c · fm084

Question 10: D An overdraft is a flexible, repayable-on-demand facility for short-term needs; a term loan provides a fixed sum repaid over an agreed longer-term period

An overdraft is a flexible facility, usually repayable on demand and intended for short-term, fluctuating working-capital needs, with interest charged only on the amount drawn. A term loan provides a fixed sum for a set period with a scheduled repayment profile, suited to longer-term financing. Option A is not always true, option B reverses the two facilities, and option C wrongly treats them as identical long-term finance.

Section E, Bank overdraft versus term loan · Ref E1a · fm098

Question 11: B 6%

Under Gordon's growth model, g = retention ratio × return on reinvested funds = 0.40 × 0.15 = 0.06 = 6%. Growth is generated by reinvesting retained profits at the rate of return the company earns on them. Option A is the return on reinvestment alone, option C is the retention ratio alone, and option D simply adds the two figures. The retained proportion and the return earned on it together drive sustainable dividend growth.

Section E, Estimating the dividend growth rate · Ref E2a · fm102

Question 12: A 10.0%

WACC = (proportion of equity × cost of equity) + (proportion of debt × after-tax cost of debt). Total value = £10m, so the equity weight is 0.6 and the debt weight is 0.4. WACC = (0.6 × 12%) + (0.4 × 7%) = 7.2% + 2.8% = 10.0%. Option D simply adds the two costs, and options B and C come from incorrect weightings such as book values or equal weights. Market values must be used for the weights.

Section E, WACC — calculation · Ref E2d · fm109

Question 13: D £3.00

The dividend growth model gives P0 = D1 ÷ (Ke − g) = 21p ÷ (0.12 − 0.05) = 21p ÷ 0.07 = £3.00. The model values the share as a growing perpetuity of dividends discounted at the required return less the growth rate. Option C divides by the growth rate alone, while options A and B use the wrong numerator or denominator. The valuation is sensitive to the growth and required-return assumptions because they appear as a small difference in the denominator.

Section F, Dividend growth model — share value · Ref F2c · fm124

Question 14: B It values the separable net assets but ignores the company's ability to generate future earnings and any internally generated goodwill

The net asset method values a business at the worth of its separable net assets, but it ignores the company's earning power and the intangible value — brands, know-how, internally generated goodwill — that often makes a business worth more than its balance sheet suggests. It also depends heavily on whether assets are stated at book, replacement or realisable values. It can certainly be calculated (option A), it usually gives a lower figure than earnings methods (option C), and it is not restricted to NFPs (option D).

Section F, Limitations of asset-based valuation · Ref F2a · fm135

Question 15: C They give the holder the right, but not the obligation, to deal at a set interest rate, protecting against adverse moves while allowing benefit from favourable ones

An interest rate option, such as a cap, gives the holder the right, but not the obligation, to borrow or lend at a set interest rate, in return for a premium. This protects against adverse interest rate movements while still allowing the holder to benefit if rates move favourably — the same asymmetry as a currency option. Option A describes a binding instrument such as a future or an FRA, option B is untrue, and option D is nonsensical. (The FM syllabus requires no numerical interest rate option calculations.)

Section G, Interest rate options · Ref G4b · fm150