

CHARTERED FINANCIAL ANALYST (CFA) LEVEL 1 PRACTICE EXAM (SAMPLE) STUDY GUIDE



SAMPLE STUDY GUIDE WITH LIMITED QUESTIONS

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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. Which of the following ratios focuses specifically on the efficiency of collecting receivables?**
 - A. Inventory Turnover
 - B. Days Sales Outstanding
 - C. Working Capital Turnover
 - D. Payable Turnover
- 2. How is the Price to Earnings (P/E) ratio calculated?**
 - A. Price per share / Earnings per share
 - B. Price per share / Cash flow per share
 - C. Price per share / Sales per share
 - D. Price per share / Book value per share
- 3. What is Gross Profit Margin calculated as?**
 - A. Gross Profit + Revenue
 - B. Gross Profit / Net Income
 - C. Gross Profit / Revenue
 - D. Net Income / Revenue
- 4. What is an option in financial markets?**
 - A. A contract that allows for mandatory buying or selling of an asset
 - B. A contract that gives the holder the right, but not the obligation, to buy or sell an asset at a predetermined price
 - C. A fixed-income investment guaranteeing returns over a specified time frame
 - D. A method of diversifying risk by investing in multiple assets
- 5. What is the significance of credit ratings?**
 - A. They are a measurement of the gross domestic product
 - B. They assess the creditworthiness of borrowers, impacting interest rates and investment decisions
 - C. They determine stock prices in financial markets
 - D. They evaluate the performance of financial advisors

- 6. How do you calculate the Number of Days Payables?**
- A. Days in accounting period / purchases
 - B. Days in accounting period / payables turnover
 - C. Average payables / total purchases
 - D. Purchases / average payables
- 7. Which of the following ratios helps determine a company's financial leverage?**
- A. Retention rate
 - B. Cash flow to revenue
 - C. Debt to capital ratio
 - D. Current ratio
- 8. Which of the following is a key factor affecting inflation rates?**
- A. Government regulations
 - B. Market competition
 - C. Consumer spending
 - D. Trade deficits
- 9. In which scenario would interest expense be added back when calculating FCFF?**
- A. When it is subtracted from operating cash flow
 - B. When it is recorded as an operating expense
 - C. When converting net income to cash flow
 - D. When calculating the total liabilities
- 10. What is arbitrage pricing theory (APT)?**
- A. A single-factor model for asset pricing
 - B. An approach to asset pricing focused solely on interest rates
 - C. An alternative to the CAPM that considers multiple factors in asset pricing
 - D. A method of trade execution that minimizes transaction costs

Answers

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

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Explanations

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1. Which of the following ratios focuses specifically on the efficiency of collecting receivables?

- A. Inventory Turnover
- B. Days Sales Outstanding**
- C. Working Capital Turnover
- D. Payable Turnover

The focus of the ratio that specifically assesses the efficiency of collecting receivables is Days Sales Outstanding (DSO). This ratio measures the average number of days it takes for a company to collect payment after a sale has been made. It is calculated by taking accounts receivable, dividing it by total credit sales for a period, and then multiplying by the number of days in that period. A lower DSO indicates that a company collects its receivables more quickly, while a higher DSO may suggest inefficiencies in the collection process or issues with credit policies. In the context of the other ratios, Inventory Turnover measures how efficiently a company manages and sells its inventory, Working Capital Turnover assesses how well a company uses its working capital to generate sales, and Payable Turnover evaluates how quickly a company pays off its suppliers. While all these ratios provide valuable insights into a company's financial performance, only Days Sales Outstanding specifically targets the efficiency of collecting receivables.

2. How is the Price to Earnings (P/E) ratio calculated?

- A. Price per share / Earnings per share**
- B. Price per share / Cash flow per share
- C. Price per share / Sales per share
- D. Price per share / Book value per share

The calculation of the Price to Earnings (P/E) ratio is done by dividing the price per share by the earnings per share. This metric is widely used in finance to evaluate a company's relative value and to compare its current share price to its earnings, which can indicate if the stock is overvalued or undervalued. The P/E ratio provides insight into how much investors are willing to pay for each dollar of earnings, allowing analysts and investors to assess the company's profitability relative to its share price. A higher P/E ratio may suggest that the market expects future growth and profitability, while a lower ratio might indicate the opposite or suggest that the stock may be undervalued relative to its earnings. The other options involve different financial metrics that do not relate to the standard calculation of the P/E ratio. Cash flow per share, sales per share, and book value per share are components relevant in other contexts, such as cash flow analysis, revenue multiples, and valuation against net assets, respectively, but they do not form part of the P/E ratio calculation.

3. What is Gross Profit Margin calculated as?

- A. Gross Profit + Revenue
- B. Gross Profit / Net Income
- C. Gross Profit / Revenue**
- D. Net Income / Revenue

The Gross Profit Margin is a key financial metric that assesses a company's financial health by revealing the percentage of revenue that exceeds the cost of goods sold (COGS). This calculation is done by dividing Gross Profit by Revenue. Gross Profit is determined by subtracting the cost of goods sold from total revenue, indicating how effectively a company is producing its goods and controlling costs associated with their production. The formula is thus represented as: $\text{Gross Profit Margin} = \text{Gross Profit} / \text{Revenue}$. A high gross profit margin indicates that a company retains a significant portion of revenues as profit, which can be used for other expenses, investments, or reinvested back into the business. This ratio is particularly useful for comparing the profitability of companies within the same industry. The other options provided do not accurately reflect the calculation of Gross Profit Margin: - "Gross Profit + Revenue" does not provide a percentage and does not relate to profitability. - "Gross Profit / Net Income" uses net income, which is affected by other expenses and taxes, hence not a direct measure of gross profitability. - "Net Income / Revenue" calculates the net profit margin, which considers all expenses and income, rather than just the cost of goods sold. Overall, understanding the gross profit margin is crucial for

4. What is an option in financial markets?

- A. A contract that allows for mandatory buying or selling of an asset
- B. A contract that gives the holder the right, but not the obligation, to buy or sell an asset at a predetermined price**
- C. A fixed-income investment guaranteeing returns over a specified time frame
- D. A method of diversifying risk by investing in multiple assets

An option in financial markets is accurately defined as a contract that provides the holder the right, but not the obligation, to buy or sell an asset at a predetermined price within a specified time frame. This unique characteristic of options is what sets them apart from other financial instruments. Specifically, in the case of call options, the holder has the right to purchase an underlying asset, while put options give the holder the right to sell the asset. The predetermined price is referred to as the strike price, and the period allowed for exercising this right is defined by the expiration date of the option. This flexibility allows investors to engage in strategic financial planning, manage risk, and speculate on price movements without the obligation to execute the transaction if market conditions are unfavorable. Additionally, this unique structure allows for hedging against adverse price movements and leveraging potential gains which can be particularly beneficial in volatile markets. The key takeaway is that options are primarily about flexibility and choice, giving investors the ability to tailor their strategies according to market conditions and their own risk tolerance.

5. What is the significance of credit ratings?

- A. They are a measurement of the gross domestic product
- B. They assess the creditworthiness of borrowers, impacting interest rates and investment decisions**
- C. They determine stock prices in financial markets
- D. They evaluate the performance of financial advisors

The significance of credit ratings primarily lies in their role in assessing the creditworthiness of borrowers, which in turn affects interest rates and investment decisions. Credit ratings provide an opinion about the ability of a borrower—whether an individual, corporation, or government—to meet its financial obligations. A higher credit rating indicates lower risk associated with an investment, leading to lower interest rates on borrowed funds. Conversely, a lower credit rating suggests greater risk, which often results in higher interest rates to compensate lenders for taking on that risk. Additionally, investors and financial institutions utilize credit ratings to make informed investment decisions. For example, a bond rated as investment grade may attract more investors compared to one rated as junk, influencing market dynamics and the cost of borrowing for the issuer. Thus, option B correctly highlights the critical function that credit ratings play in the broader context of financial markets and economic activity.

6. How do you calculate the Number of Days Payables?

- A. Days in accounting period / purchases
- B. Days in accounting period / payables turnover**
- C. Average payables / total purchases
- D. Purchases / average payables

The Number of Days Payables is an important measure used to understand how long a company takes to pay its suppliers. To calculate this figure, it is often derived from the payables turnover ratio, which reflects how quickly a company pays off its suppliers. The payables turnover ratio is calculated as the ratio of total purchases to the average payables. By rearranging this formula, you can derive the Number of Days Payables. Specifically, the formula for the Number of Days Payables is: $\text{Number of Days Payables} = \text{Days in the accounting period} / \text{Payables Turnover Ratio}$. This shows that the longer it takes to pay suppliers, the higher the Number of Days Payables will be, indicating the extent of credit a company is using. Thus, the approach of dividing the days in the accounting period by the payables turnover gives a clear and direct method to arrive at the Number of Days Payables, which aligns with the established financial norms for this metric.

7. Which of the following ratios helps determine a company's financial leverage?

- A. Retention rate
- B. Cash flow to revenue
- C. Debt to capital ratio**
- D. Current ratio

The debt to capital ratio is a key measure that indicates the extent to which a company is utilizing debt to finance its operations compared to its overall capital structure, which includes both debt and equity. This ratio provides insight into a company's financial leverage by expressing the proportion of debt in relation to total capital. A higher ratio suggests that a company is more leveraged, relying more on debt for financing, which can amplify both returns and risks. It shows how much of the company's capital is sourced from debt, making it crucial for assessing the financial risk associated with the firm's capital structure. The retention rate relates to how much profit a company retains versus how much is distributed to shareholders, rather than providing insights into leverage. Cash flow to revenue focuses on the efficiency of cash generation relative to sales, not specifically measuring leverage. The current ratio assesses a company's ability to meet its short-term obligations with its short-term assets, which is more about liquidity than leverage. Thus, the debt to capital ratio is the most relevant measure for understanding a company's financial leverage.

8. Which of the following is a key factor affecting inflation rates?

- A. Government regulations
- B. Market competition
- C. Consumer spending**
- D. Trade deficits

Consumer spending plays a crucial role in determining inflation rates. When consumer spending increases, demand for goods and services rises. If this demand outstrips supply, it can lead to higher prices, thereby contributing to inflation. The relationship is grounded in the principles of supply and demand; when more consumers are willing to purchase products, businesses may respond by raising prices, especially if they are unable to increase production quickly enough to meet that demand. In economic terms, this increase in demand can create a "demand-pull" inflation scenario, where the rising demand directly influences price levels. Factors such as consumer confidence, disposable income, and access to credit can all affect consumer spending levels, which in turn impact inflation rates significantly. While government regulations, market competition, and trade deficits can influence inflation, they do so in more indirect or varying ways, and thus are not considered as direct key drivers in the same immediate manner as consumer spending.

9. In which scenario would interest expense be added back when calculating FCFF?

- A. When it is subtracted from operating cash flow**
- B. When it is recorded as an operating expense
- C. When converting net income to cash flow
- D. When calculating the total liabilities

When calculating Free Cash Flow to the Firm (FCFF), interest expenses are typically treated differently from the operating profit calculations. In the context of FCFF, interest expenses are generally added back to net income because FCFF is intended to measure the cash available to all providers of capital, both debt and equity. This means that it needs to reflect the company's overall cash flow situation before considering interest payments that are a cost of financing rather than an operational cost. In the scenario where interest expense has been subtracted from operating cash flow, adding it back becomes necessary to accurately reflect the cash flow available to the firm itself rather than to its equity holders only. By adding back interest expense, one restores the cash flow figure to its full potential, effectively giving a clearer picture of the operating cash generation before financing costs are considered. This treatment aligns with the principle that FCFF should represent cash flows available to all capital providers. The other scenarios do not directly involve adjusting the cash flow measures used for FCFF calculation in a way that would necessitate adding back interest expense to reflect the firm's total cash flow accurately.

10. What is arbitrage pricing theory (APT)?

- A. A single-factor model for asset pricing
- B. An approach to asset pricing focused solely on interest rates
- C. An alternative to the CAPM that considers multiple factors in asset pricing**
- D. A method of trade execution that minimizes transaction costs

Arbitrage Pricing Theory (APT) is indeed an alternative to the Capital Asset Pricing Model (CAPM) that incorporates multiple factors in asset pricing. Unlike CAPM, which relies on a single market risk factor (the market portfolio), APT allows for a more nuanced analysis by considering various systematic factors that could affect an asset's return. These factors might include economic indicators, inflation rates, interest rates, and other variables that may impact financial markets. The strength of APT lies in its flexibility; it provides a framework for investors to identify how different factors interact and influence asset prices without being tied to the strict assumptions that CAPM makes, such as market efficiency and investor behavior. This multi-faceted approach helps explain asset returns better, particularly in complex and dynamic markets. In contrast to the other options, APT does not simplify asset pricing to a single factor – shown in the misunderstanding of whether it emphasizes only interest rates or focuses purely on trading efficiency or execution methods. APT is fundamentally about the relationship between multiple risk factors and expected returns, acknowledging that investors must consider a wider array of influences when assessing the value of an asset.

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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