CFA-LEVEL-1 Q&As

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QUESTION 1

Given the academic research supporting the efficiency of the stock market, which of the following is the least accurate description of a portfolio manager\\'s role in an efficient market?

A. Identifying and specifying a client\\'s objectives and constraints.

B. Specifying an explicit investment strategy to meet the client\\'s needs.

C. Diversifying the client\\'s portfolio across all asset classes to eliminate systematic risk.

Correct Answer: C

QUESTION 2

Given the following information on the annual operating results for ArtFrames, a producer of quality metal

picture frames, calculate the degree of operating leverage (DOL) and the degree of financial leverage

(DFL).

Which of the following choices is closest to the correct answer? ArtFrameDOL and DFL are, respectively:

A. 3.00 and 1.50.

B. 2.20 and 1.06.

C. 2.20 and 1.08.

D. 4.53 and 1.19.

Correct Answer: C

The calculations are as follows:

ArtFrames Annual Operating Results

Sales	$3,500,000
Variable Costs[1]	1,575,000
	1,925,000
Fixed Costs	1,050,000
EBIT	875,000
Interest Expense[2]	67,500
	807,500

1Variable costs = 0.45 * 3,500,000

2Interest Expense = 0.09 * 750,000

Second,calculate DOL:

DOL = (Sales ?Variable Costs) / (Sales ?Variable Costs ?Fixed Costs)

= (3,500,000 ?1,575,000) / (3,500,000 ?1,575,000 ?1,050,000) =2.20

Third,calculate DFL:

DFL = EBIT / (EBIT ?I) = 875,000 / 807,500 =1.08.

QUESTION 3

Which of the following firm\\'s earnings per share (EPS) figure would be least sensitive to a percentage change in Earnings Before Interest and Taxes (EBIT)? Firm A EBIT: $6,800,000 Interest Paid: $505,000 Total Operating Expenses: $80,000,000 Fixed Operating Expenses: $50,250,000 Firm B EBIT: $20,000,000 Interest Paid: $600,000 Total Operating Expenses: $40,000,000 Fixed Operating Expenses: $30,250,000 Firm C EBIT: $50,500,000 Interest Paid: $3,500,000 Total Operating Expenses: $66,000,000 Fixed Operating Expenses: $30,750,000 Firm D EBIT: $49,700,000 Interest Paid: $7,750,000 Total Operating Expenses: $90,000,000 Fixed Operating Expenses: $75,000,000 Firm E EBIT: $43,000,000 Interest Paid: $7,000,000 Total Operating Expenses: $85,000,000 Fixed Operating Expenses: $60,500,000

A. The answer cannot be determined from the information provided.

B. Firm B

C. Firm A

D. Firm D

E. Firm C

F. Firm E

Correct Answer: B

This question is asking you to calculate the Degree of Financial Leverage for each company. The Degree of Financial Leverage (DFL) measures the percentage change in EPS that results from a given percentage change in EBIT. Financial Leverage is the second component of total leverage, along with Operating Leverage. The equation used to calculate the Degree of Financial Leverage is as follows: {DFL = [EBIT/ (EBIT - Interest Paid)]}. As companies incorporate more debt in their capital structure, their EPS figure will become more sensitive to fluctuations occurring from interest payments, and this is evidenced by an increase in the Degree of Financial Leverage. In this example, Firm B has the lowest DFL with a figure of

1.031. In light of this information, it can be concluded that firm B has an EPS figure which is the least sensitive to a given change in EBIT. When calculating the DFL figure, remember that the answer can never be less than one, and can never be negative. In a situation where the company under examination has zero debt, and no preferred stock dividends (and therefore no interest expense for purposes of the DFL equation), the DFL would be equal to one. It is important note to remember is that in calculating the Degree of Financial Leverage, dividend payments to preferred stockholders should be included in the interest expense figure. Operating expenses are not factored into the DFL calculation, rather are used in the determination of Operating Leverage.

QUESTION 4

According to FASB, initial franchise fees should be recognized as income when

A. the franchisee shows the ability to pay the fee.

B. the franchisor has substantially performed or satisfied all material services and conditions.

C. the franchisor has collected the majority of fee in cash.

D. the franchisor bills the franchisee.

Correct Answer: B

Accounting and reporting standards for franchisors require that revenue be recognized when the franchisor has substantially performed or satisfied all material services and conditions.

QUESTION 5

Which of the following is not a violation of Standard II (C)?

A. Using a chart that was prepared by another analyst in a presentation, without acknowledgment.

B. All of these answers are violations.

C. Giving an oral report and citing specific quotations, attributable to "leading analysts," without specific reference.

D. Use of statistical information provided by Standard and Poor\\'s, without acknowledgment.

E. Use of a small part of an analyst\\'s work who is employed in a completely different (non-competitive) industry, without acknowledgment.

Correct Answer: D

Using excerpts from articles or reports prepared by others, either verbatim, or with only a slight change, without acknowledgment; citing specific quotations, attributable to "leading analysts," without specific reference; using charts or graphs without stating their sources; and copying proprietary computerized spreadsheets or algorithms without seeking the authorization of their creators - all of these practices are violations of Standard II (C). Only globally recognized sources of factual material such as that provided by Standard and Poor\\'s, or Moody\\'s Investors Service, can be used without acknowledgment, since such information is already in the public realm.