

2017 Level I Mock Exam: Morning Session

The morning session of the 2017 Level I Chartered Financial Analyst (CFA®) Mock Examination has 120 questions. To best simulate the exam day experience, candidates are advised to allocate an average of 1.5 minutes per question for a total of 180 minutes (3 hours) for this session of the exam.

	Topic	Minutes
1-18	Ethical and Professional Standards	27
19-32	Quantitative Methods	21
33-44	Economics	18
45-68	Financial Statement Analysis	36
69-76	Corporate Finance	12
77-88	Equity Investments	18
89-94	Derivative Investments	9
95-106	Fixed Income Investments	18
107-110	Alternative Investments	6
111-120	Portfolio Management	15
	Total:	180

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1. In cases where applicable local laws governing calculation and presentation of investment performance conflict with the GIPS standards, firms are:
 - A. required to comply with local regulations and make full disclosure of the conflict to claim GIPS compliance.
 - B. unable to claim GIPS compliance in cases where local regulations prohibit accurate calculation.
 - C. required to calculate and maintain two sets of performance data in order to claim GIPS compliance.

2. Ross Nelson, CFA, manages accounts for high-net-worth clients, including his own family's account. He has no beneficial ownership in his family's account. Because Nelson is concerned about the appearance of improper behavior in managing his family's account, when his firm purchases a block of securities, Nelson allocates to his family's account only those shares that remain after his other client accounts have their orders filled. The fee for managing his family's account is based on his firm's normal fee structure. According to the *Standards of Practice Handbook*, Nelson's best course of action with regard to management of his family's account would be to:
 - A. treat the account like other employee accounts of the firm.
 - B. treat the account like other client accounts.
 - C. remove himself from any direct involvement by transferring responsibility for this account to another investment professional in the firm.

3. Alexander Newton, CFA, is the chief compliance officer for Mills Investment Limited. Newton institutes a new policy requiring the pro rata distribution of new security issues to all established discretionary accounts for which the new issues are appropriate. The policy also provides for the exclusion of newly established discretionary accounts from the distribution until they have reached their one-month anniversary date. This policy is disclosed to all existing and potential clients. Did Newton *most likely* violate any CFA Institute Standards of Professional Conduct?
 - A. No, because the policy has been adequately disclosed to all existing and potential clients
 - B. Yes
 - C. No, because the allocation policy is not inequitable under the standards

4. According to the GIPS standards a verification report confirms all of the following *except* whether:
 - A. specific composite presentations are accurate.
 - B. processes and procedures are designed to calculate and present compliant performance results.
 - C. a firm has complied with all firm-wide composite construction requirements.

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5. Justin Blake, CFA, a retired portfolio manager, owns 20,000 shares of a small public company that he would like to sell because he is worried about the company's prospects. He posts messages on several internet bulletin boards. The messages read, "This stock is going up once the pending patents are released, so now is the time to buy. The stock is a buy at anything below \$3. I have done some close research on these guys." According to the *Standards of Practice Handbook*, Blake *most likely* violated the Code and Standards associated with:
 - A. Integrity of Capital Markets, but not Conflicts of Interest.
 - B. neither Integrity of Capital Markets nor Conflicts of Interest.
 - C. Integrity of Capital Markets, and Conflicts of Interest.

6. Miranda Grafton, CFA, purchased a large block of stock at varying prices during the trading session. The stock realized a significant gain in value before the close of the trading day, so Grafton reviewed her purchase prices to determine what prices should be assigned to each specific account. According to the *Standards of Practice Handbook*, Grafton's *least* appropriate action is to allocate the execution prices:
 - A. across the participating client accounts at the same execution price.
 - B. across the participating client accounts pro rata on the basis of account size.
 - C. on a first-in, first-out basis with consideration of bundling orders for efficiency.

7. Which of the following *least likely* reflects the two primary principles of the CFA Institute Rules of Procedure for Professional Conduct?
 - A. Fair process to the member and candidate
 - B. Public disclosure of disciplinary sanctions
 - C. Confidentiality of proceedings

8. Several years ago, Leo Peek, CFA, co-founded an investment club. The club is fully invested but has not actively traded its account for at least a year and does not plan to resume active trading of the account. Peek's employer requires an annual disclosure of employee stock ownership. Peek discloses all of his personal trading accounts but does not disclose his holdings in the investment club. Peek's actions are *least likely* to be a violation of which of the CFA Institute Standards of Professional Conduct?
 - A. Misrepresentation

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- B. Transaction priority
 - C. Conflicts of interest
9. Madeline Smith, CFA, was recently promoted to senior portfolio manager. In her new position, Smith is required to supervise three portfolio managers. Smith asks for a copy of her firm's written supervisory policies and procedures but is advised that no such policies are required by regulatory standards in the country where Smith works. According to the *Standards of Practice Handbook*, Smith's *most* appropriate course of action would be to:
- A. require her firm to adopt the CFA Institute Code of Ethics and Standards of Professional Conduct.
 - B. decline to accept supervisory responsibility until her firm adopts procedures to allow her to adequately exercise such responsibility.
 - C. require the employees she supervises to adopt the CFA Institute Code of Ethics and Standards of Professional Conduct.
10. When Jefferson Piedmont, CFA, joined Branch Investing, Branch began using a quantitative stock selection model Piedmont had developed on his own personal time prior to his employment with Branch. One year later when Piedmont left Branch Investing, he found the original copy of the model he had developed in a file at his home and presented it to his new employer, which immediately began using the model. According to the *Standards of Practice Handbook*, did Piedmont *most likely* violate any CFA Institute Standards of Professional Conduct?
- A. No
 - B. Yes, because he misappropriated property now belonging to Branch
 - C. Yes, because he failed to inform his new employer the model was the same one used by his previous employer
11. Reiko Kimisaki, CFA, is an investment adviser for a national social security fund in a frontier market with a very limited and illiquid capital market. The labor force is young and has an investment time horizon of 25 to 30 years. Kimisaki has been asked to suggest ways to increase the investment return of the overall portfolio. After careful assessment of the fund's previous investment history, and available asset classes, she considers investment in private equity. What is Kimisaki's lowest priority to avoid any Code and Standards violations prior to making this investment recommendation?
- A. Assess the risk tolerance of the fund.
 - B. Analyze the expected returns of private equity in the market.

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- C. Determine whether the investment policy statement allows for alternative investments.
12. Rebecca Wong is enrolled to take the Level I CFA exam. Her friend William Leung purchased Level I study materials from a well-known CFA review program the previous year. Leung made a photocopy of the previous year's copyrighted materials and sold it to Wong to help her study. Who *most likely* violated the CFA Institute Code of Ethics or any Standards of Professional Conduct?
- A. Neither violated.
 - B. Both violated.
 - C. Only Leung violated.
13. According to the Global Investment Performance Standards (GIPS), firms must do all of the following *except*:
- A. provide investors with a comprehensive view of their performance only in terms of returns.
 - B. adhere to certain calculation methodologies and make specific disclosures along with their performance.
 - C. comply with all requirements of the GIPS standards, such as updates, guidance statements, and clarifications.
14. For firms to claim compliance with the GIPS standards they *most likely* must:
- A. increase the consistency and quality of the firm's compliant presentations.
 - B. take responsibility for their claim of compliance and maintaining that compliance.
 - C. hire an independent third party to test a sample of their composites.
15. While waiting in the business class lounge before boarding an airplane, Becca Msafari, CFA, an equity analyst, overhears a conversation by a group of senior managers, including members of the board, from a large publicly listed bank. The managers discuss staff changes necessary to accommodate their regional expansion plans. Msafari hears several staff names mentioned. Under what circumstances could Msafari *most likely* use this information when making an investment recommendation to her clients? She can use the information:
- A. under no circumstances.
 - B. if she does not breach the confidentiality of the names of the staff.
 - C. if the discussed changes are unlikely to affect investor perception of the bank.

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16. Fundamental Asset Managers claims compliance with the CFA Institute Global Investment Performance Standards (GIPS) and manages both discretionary and non-discretionary accounts. When constructing a single composite for Fundamental, Juma Dzuya includes all discretionary, fee-paying accounts with both value and growth strategies. Does the composite constructed by Dzuya *most likely* meet the criteria of the GIPS standards?
- A. No, because of non-similar investment strategies
 - B. No, because non-discretionary accounts are not included
 - C. Yes
17. Charlie Mancini, CFA, is the Managing Director for Business Development at SV Financial, (SVF), a large U.S.-based mutual fund organization. Mancini has been under pressure recently to increase revenues. In order to secure business from a large hedge fund manager based in Asia, Mancini recently approved flexible terms for the fund's client agreement. To allow for time zone differences, the agreement permits the hedge fund to trade in all of SVF's mutual funds six hours after the close of U.S. markets, which is prohibited by U.S. regulators. Did Mancini violate any CFA Institute Standards of Professional Conduct?
- A. No
 - B. Yes, with regard to Fair Dealing and Material Nonpublic Information
 - C. Yes, with regard to Fair Dealing
18. In order to achieve compliance with GIPS Standards, it is recommended that firms:
- A. define the firm by including all geographical offices operating under the same firm name.
 - B. provide existing clients a compliant presentation applicable to their portfolio, at a minimum of a bi-annual basis.
 - C. adopt the broadest, most meaningful definition of the firm.
19. The discrepancy between a statistically significant result and an economically meaningful result is *least likely* the result of:
- A. transaction costs.
 - B. sampling errors.
 - C. risk tolerance.

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20. A small-cap growth fund's monthly returns for the past 36 months have been consistently outperforming its benchmark. An analyst is determining whether the standard deviation of monthly returns is greater than 6%. Which of the following *best* describes the hypothesis to be tested?
- A. $H_0: \sigma^2 \geq 0.36\%$
 - B. $H_a: \sigma^2 > 6\%$
 - C. $H_0: \sigma^2 \leq 0.36\%$
21. When testing a hypothesis, the power of a test is *best* described as the:
- A. probability of rejecting a true null hypothesis.
 - B. probability of correctly rejecting the null hypothesis.
 - C. same as the level of significance of the test.
22. A company has an unsecured line of credit and needs to maintain its EBIT-to-interest coverage ratio greater than 2.0. Its EBIT is estimated to be between \$36 million and \$48 million, with all values equally likely. If the forecasted interest charge for the year is \$20 million, the probability that EBIT/interest will be more than 2.0 is *closest* to:
- A. 33.3%.
 - B. 66.7%.
 - C. 61.5%.
23. If the stated annual interest rate is 9% and the frequency of compounding is daily, the effective annual rate (EAR) is *closest* to:
- A. 9.00%.
 - B. 9.86%.
 - C. 9.42%.

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24. A financial contract offers to pay €1,200 per month for five years with the first payment made immediately. Assuming an annual discount rate of 6.5%, compounded monthly the present value of the contract is *closest* to:
- A. €61,663.
 - B. €61,330.
 - C. €63,731.
25. Use the following values from a student's t -distribution to establish a 95% confidence interval for the population mean given a sample size of 10, a sample mean of 6.25, and a sample standard deviation of 12. Assume that the population from which the sample is drawn is normally distributed and the population variance is not known.


Degrees of Freedom	$p = 0.10$	$p = 0.05$	$p = 0.025$	$p = 0.01$
9	1.383	1.833	2.262	2.821
10	1.372	1.812	2.228	2.764
11	1.363	1.796	2.201	2.718

The 95% confidence interval is *closest* to a:

- A. lower bound of -2.20 and an upper bound of 14.70.
 - B. lower bound of -2.33 and an upper bound of 14.83.
 - C. lower bound of -0.71 and an upper bound of 13.21.
26. Investors should be *most* attracted to return distributions that are:
- A. normal.
 - B. negatively skewed.
 - C. positively skewed.

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27.

<p>The figure to the right shows the histogram for the distribution of weekly returns on an index.</p> <p>The median of the returns on the index, if compared to the mean, will <i>most likely</i> be:</p>	
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- A. smaller.
- B. greater.
- C. equal.

28. A discrete uniform distribution consists of the following 12 values:

-2.5	5.3	6.7	8.8	-4.6	9.2
3.3	8.2	1.4	0.8	-5.3	6.9

On a single draw from the distribution, the probability of drawing a value between -2.0 and 2.0 from the distribution is *closest* to:

- A. 16.67%.
- B. 27.59%.
- C. 33.33%.

29. A descriptive measure of a population characteristic is *best* described as a:

- A. parameter.

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- B. frequency distribution.
 - C. sample statistic.
30. The arithmetic and geometric mean are calculated for the same data. If there is variability in the data, compared with the arithmetic mean, the geometric mean will *most likely* be:
- A. smaller.
 - B. greater.
 - C. equal.
31. Which of the following *most* accurately describes a distribution that is more peaked than normal?
- A. Mesokurtotic
 - B. Platykurtotic
 - C. Leptokurtotic
32. The null hypothesis is *most likely* to be rejected when the p -value of the test statistic:
- A. falls below a specified level of significance.
 - B. exceeds a specified level of significance.
 - C. is negative.

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33. The following information applies to a start-up company solely owned by an entrepreneur.

	Value
Total units produced	3,550
Average revenue	\$1,110
Average variable cost	\$750
Total fixed cost	\$300,000
Total investment	\$1,550,000
Required rate of return	12.5%
Opportunity cost of owner's labor	\$125,000

The company's economic profit is *closest to*:

- A. \$659,250.
 - B. \$784,250.
 - C. \$318,750.
34. Which of the following statements concerning the Herfindahl–Hirschman Index (HHI) is *most* accurate?
- A. The HHI is a useful measure of potential barriers to entry.
 - B. The HHI is usually unaffected by mergers among the top market incumbents.
 - C. An HHI of 0.05 would be analogous to having the market shared equally by 20 firms.
35. If the quantity demanded of pears falls by 4% when the price of apples decreases by 3%, then apples and pears are *best* described as:
- A. substitutes.
 - B. inferior goods.
 - C. complements.

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36. In a country with a high level of income, as domestic income rises, it is *most likely* that an increase will occur in:
- A. private saving and investment.
 - B. the fiscal balance.
 - C. the trade balance.
37. Assuming all other factors remain unchanged, which of the following changes would *most likely* cause a simultaneous increase in the participation ratio and a decrease in the unemployment rate?
- A. An increase in the number of people included in the labor force.
 - B. A decrease in the total population of working age people.
 - C. A decrease in the number of unemployed people.
38. Three firms operate under perfect competition, producing 900 units of the same product but using different production technologies. Each company's cost structure is indicated in the table:

Company	X	Y	Z
Total Variable Costs	\$2,700	\$3,600	\$4,500
Total Fixed Costs	<u>2,700</u>	<u>1,800</u>	<u>900</u>
Total Costs	\$5,400	\$5,400	\$5,400

- Which of the following statements is *most* accurate? If the unit selling price is:
- A. \$4.50, all firms should continue to operate in the short run, but exit the market in the long run if these conditions are expected to persist.
 - B. \$3.00, Firm X should continue to operate in the short run, but Firms Y and Z should shut down production.
 - C. \$6.00, all firms should exit the market in the long run.
39. Which of the following statements is *most* accurate concerning the sum-of-value-added method used to determine GDP based on expenditures?
- A. The method shows a larger GDP value compared with the value-of-final-output method.
 - B. The method is based on the prices consumers pay for the products and services.

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- C. The method involves summing the income created at each stage of the production and distribution process.

40. A New Zealand traveler returned from Singapore with SGD7,500 (Singapore dollars). A foreign exchange dealer provided the traveler with the following quotes:

Ratio	Spot Rates
USD/SGD	1.2600
NZD/USD	0.7670
USD: US dollar NZD: New Zealand dollar	

The amount of New Zealand dollars (NZD) that the traveler would receive for his Singapore dollars is *closest* to:

- A. NZD7,248.
B. NZD7,761.
C. NZD4,565.
41. Which of the following statements with respect to Giffen and Veblen goods is *least* accurate?
- A. Giffen goods are "inferior," whereas Veblen goods are "high-status" goods.
B. Both types of goods demonstrate the possibility of a positively sloping demand curve.
C. Both types of goods violate the fundamental axioms of demand theory.
42. If a strengthening economy leads discouraged workers to return to an active employment search, at least initially, the number of unemployed people would *most likely*:
- A. increase.
B. decrease.
C. remain unchanged.

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43. A member of the labor force quit her job last week and will begin a new job next week. During this interim period, for the purposes of calculating unemployment statistics, this person is *most likely* classified as:
- A. frictionally unemployed.
 - B. hidden unemployed.
 - C. voluntarily unemployed.
44. The monthly demand curve for playing tennis at a particular club is given by the following equation: $P_{\text{Tennis Match}} = 9 - 0.20 \times Q_{\text{Tennis Match}}$. The club currently charges members \$4.00 to play a match but is considering adding a membership fee. If the club continues to charge the same per play charge, the most that it will be able to charge as a membership fee is *closest* to:
- A. \$162.50.
 - B. \$40.00.
 - C. \$62.50.
45. According to the International Financial Reporting Standards (IFRS), which of the following conditions *should* be satisfied to report revenue from the sale of goods on the income statement?
- A. Goods have been delivered to the customer.
 - B. Payment has been received.
 - C. Costs can be reliably measured.

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46. At the start of the year a company that uses U.S. GAAP entered a contract to design and build a bridge with the following terms:

Contract length	3 years
Fixed contract price	\$40 million
Estimated contract cost	\$32 million
Costs incurred in first year	\$12 million

The company was initially quite certain about its cost estimates and intended to recognize revenue based on them. However, unexpected problems during the first year have caused engineers to suggest that a more expensive design may be required, costing up to \$8 million more. If the appropriate design cannot be determined before the company's financial statements are issued, the difference in the amount of revenue the company would recognize is *closest* to:

- A. \$15 million.
 - B. \$ 0.
 - C. \$ 3 million.
47. Previously, a manufacturer of high-quality industrial electrical generators only sold its units to customers, but it has just introduced a leasing program. The generators have expected useful lives of about 25 years, and the company anticipates that the leases will have a term of 20 years or more. The company reports under International Financial Reporting Standards. Which of the following statements about the first year of the new leasing program is *most* accurate?
- A. If the lease is classified as an operating lease, the company's profits should be higher for a given leased asset than they would be under a finance lease.
 - B. Regardless of how the company classifies the lease, its total cash flow
 - C. If the lease is classified as a finance lease, it will decrease the company's liquidity position compared with when the company was only selling its generators.

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48. In early January 2015, an analyst sees a news release that a company he follows (which reports under US GAAP) will be forced to reduce output from one of its major product lines at its highly specialized ceramics plant in response to a new technology introduced by its major competitor. The table summarizes information and estimates that the analyst has gathered from various sources about the plant and its future prospects.

Selected Information Related to the Ceramics Production Plant End of 2014 (\$ thousands)	
Carrying amount of plant	1,604
Undiscounted expected future net cash flows	1,350
Present value of expected future net cash flows	1,050
Fair value of plant	1,225
Revised estimate of useful life	4 years
Depreciation method	Straight line
Revised estimate of residual value	\$200

If the above information and estimates prove accurate, the depreciation expense that should be reported for 2015 related to the plant will be *closest* to:

- A. \$213 thousand.
- B. \$306 thousand.
- C. \$256 thousand.

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49. A company incurs the following costs related to its inventory during the year:

Cost	¥ millions
Purchase price	100,000
Trade discounts	5,000
Import duties	20,000
Shipping of raw materials to manufacturing facility	10,000
Manufacturing conversion costs	50,000
Abnormal costs as a result of waste material	8,000
Storage cost of finished goods prior to shipping to customers	2,000

The amount charged to inventory cost (in millions) is *closest* to:

- A. ¥177,000.
B. ¥185,000.
C. ¥175,000.
50. The following is selected balance sheet data for a company along with information about its financial and operating lease obligations.

	As of 31 December 2014 (€ millions)
Long-term debt	1,347
Total shareholder's equity	11,268
Total assets	20,097

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Note 18. Financial and Operating Leases

A. Financial Leases

The implicit interest rate on finance leases for 2014 was 6.0%.

B. Operating Lease Commitments as of 31 December 2014 (€ Millions)

Due 1 January 2015	130
Due 1 January 2016	130
Due 1 January 2017	130
Due 1 January 2018	130
Due 1 January 2019	80
Total of future lease payments thereafter*	240
Total commitments	840

*After 2019, all lease payments are assumed to be the same as in 2019.

If the company were to capitalize its long-term leases, its adjusted long-term debt-to-assets ratio as of the end of December 2014 would be *closest* to:

- A. 9.9%.
- B. 10.2%.
- C. 10.4%.

51. Which of the following is *least likely* to be a general feature underlying the preparation of financial statements within the International Financial Reporting Standards (IFRS) Conceptual Framework?

- A. Matching
- B. Materiality
- C. Accrual basis

52. At the beginning of the year, a company purchased a fixed asset for \$500,000 with no expected residual value. The company depreciates similar assets on a straight line basis over 10 years, whereas the tax authorities allow declining balance depreciation at the rate of 15% per year. In both cases, the company takes a full year's depreciation in the first year and the tax rate is 40%. Which of the following statements concerning this asset at the end of the year is *most* accurate?

- A. The deferred tax asset is \$10,000.
- B. The temporary difference is \$25,000.

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C. The tax base is \$500,000.

53. The *least likely* reason that a security analyst needs to understand the accounting process is to:

- A. aid in the assessment of management's judgment in accruals and valuations.
- B. prevent earnings manipulation by management.
- C. make adjustments to reflect items not reported in the financial statements.

54. Under International Financial Reporting Standards (IFRS), which of the following is *most likely* one of the general features underlying the preparation of financial statements?

- A. Timeliness
- B. Consistency
- C. Understandability

55. A firm that prepares its financial statements according to US GAAP and uses a periodic inventory system had the following transactions during the year:

Date	Activity	Tons (thousands)	\$ per Ton
	Beginning inventory	1	600
February	Purchase	5	650
May	Sale	2	700
August	Purchase	3	680
November	Sale	4	750

The cost of sales (in thousands) is *closest* to:

- A. \$5,890 using weighted average.
- B. \$4,080 using LIFO.
- C. \$3,850 using FIFO.

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56. The International Financial Reporting Standards (IFRS) Conceptual Framework identifies fundamental qualitative characteristics that make financial information useful. Which of the following is *least likely* to be one of these characteristics?
- Relevance
 - Materiality
 - Faithful representation
57. At the start of the year, a company acquired new equipment at a cost of €50,000, estimated to have a three-year life and a residual value of €5,000. If the company depreciates the asset using the double declining balance method, the depreciation expense that the company will report for the third year is *closest* to:
- €3,328.
 - €3,705.
 - €555.
58. During the year, a retailer purchases 1,000 units of inventory at £20.20 per unit. In addition, the following items relate to inventory acquisition and handling during the year.

Item description	£ '000s
Volume rebate received	404
Import and sales taxes	2,970
Transport and transport insurance costs	325
Storage costs of finished goods	1,250
Warehouse administrative costs	3,300

The total costs (in thousands) that will be included in inventory are *closest* to:

- £23,091.
- £22,766.
- £24,341.

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59. The convergence of global accounting standards has advanced to a degree that the Securities & Exchange Commission in the United States now mandates that foreign private issuers who use IFRS may report under:
- A. U.S. GAAP or under IFRS.
 - B. U.S. GAAP with voluntary supplemental reporting under IFRS.
 - C. U.S. GAAP or under IFRS with a reconciliation to U.S. GAAP.
60. An analyst has compiled the following information on a company:

		£ thousands
Beginning of the year values		
	Share capital	2,000
	Retained earnings	8,850
During the year		
	Revenues	12,000
	Total expenses	10,150
	Proceeds from shares issued	500
End of year values		
	Total current assets	9,200
	Total non-current assets	12,750
	Investments	350
	Total liabilities	9,400

The amount of dividends declared (£ thousands) during the year is *closest* to:

- A. 300.
- B. 150.
- C. 650.

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61. The following information is available on a company for the current year.

Net income	\$1,000,000
Average number of common shares outstanding	100,000
Details of convertible securities outstanding:	
Convertible preferred shares outstanding	2,000
o Dividend/share	\$10
o Each preferred share is convertible into five shares of common stock	
Convertible bonds, \$100 face value per bond	\$80,000
o 8% coupon	
o Each bond is convertible into 25 shares of common stock	
Corporate tax rate	40%

The company's diluted EPS is *closest* to:

- A. \$7.72.
- B. \$7.57.
- C. \$7.69.

62. Which of the following is *best* described as a necessary characteristic for an effective financial reporting framework?

- A. Consistency in the measurement basis used across the balance sheet
- B. Transparency to the underlying economics
- C. Uniform treatment of transactions by different entities

63. For which of the following inventory valuation methods is the gross profit margin *least likely* to be the same under both a perpetual inventory system and a periodic inventory system?

- A. Specific identification
- B. FIFO
- C. LIFO

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64. According to the International Accounting Standards Board's (IASB) Conceptual Framework for Financial Reporting, the two fundamental qualitative characteristics that make financial information useful are *best* described as:

- A. relevance and faithful representation.
- B. understandability and verifiability.
- C. timeliness and accrual accounting.

65. In 2015, a company undertook the following two transactions:

1.	Borrowed money from an insurance company and pledged some of its production facilities as collateral for the loan.
2.	Entered into an agreement with a local construction company to build a new research facility at a fixed price. Construction is to begin by 1 January 2016 and be completed by 31 December 2018.

With respect to required disclosures in the company's financial statements, which of the following is *most* accurate? If the company reports under:

- A. International Financial Reporting Standards (IFRS), neither transaction must be disclosed.
- B. US GAAP, only the pledged borrowing must be disclosed.
- C. US GAAP, neither transaction must be disclosed.

66. For which of the following assets is it *most* appropriate to test for impairment at least annually?

- A. A trademark with an indefinite expected life
- B. A patent with a legal life of 20 years
- C. Land

67. In a period of rising prices, when compared with a company that uses weighted average cost for inventory, a company using FIFO will *most likely* report higher values for its:

- A. debt-to-equity ratio.
- B. return on sales.
- C. inventory turnover.

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68. The following excerpt was taken from the notes of a company's financial statements that were prepared in accordance with International Financial Reporting Standards. All figures are in thousands of Australian dollars.

Note 12: Broadcast Licenses

During 2014, the company successfully disposed of broadcast licenses that were held for sale for A\$37,900 (net book value of A\$23,500). Based on the successful completion of that sale, the impairment losses taken in 2012 on other licenses have been reversed, restoring those intangible assets to their amortized historical cost. Broadcast licenses are amortized over a period of 15–25 years.

The note leads an analyst to believe that the rapid reversal of the impairment loss related to the broadcast licenses arose as an attempt by management to manage earnings.

If the analyst's belief is correct, her analysis of the original 2013 financial statements would *most likely* have shown that, compared with the economic reality in 2013, the company had:

- A. understated ROA.
 - B. understated fixed asset turnover.
 - C. overstated net profit margin.
69. A company's asset beta is 1.2 based on a debt-to-equity ratio (D/E) of 50%. If the company's tax rate increases, the associated equity beta will *most likely*:
- A. remain unchanged.
 - B. decrease.
 - C. increase.

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70. The following information is available for a company:

- Bonds are priced at par and have an annual coupon rate of 9.2%.
- Preferred stock is priced at \$8.18 and pays an annual dividend of \$1.35.
- Common equity has a beta of 1.3.
- The risk-free rate is 4% and the market premium is 11%.
- Capital structure: Debt = 30%; Preferred stock = 15%; Common equity = 55%.
- The tax rate is 35%.

The weighted average cost of capital (WACC) for the company is *closest* to:

- A. 13.4%.
- B. 14.3%.
- C. 11.5%.

71. Using the debt-rating approach to find the cost of debt is *most* appropriate when market prices for a company's debt are:

- A. stable.
- B. unreliable.
- C. below par value.

72. Given the following information about a firm:

- debt-to-equity ratio (D/E) of 50%,
- tax rate of 40%,
- cost of debt of 8%, and
- cost of equity of 13%,

the firm's weighted average cost of capital (WACC) is *closest* to:

- A. 7.5%.
- B. 8.9%.
- C. 10.3%.

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73. A 20-year \$1,000 fixed-rate non-callable bond with 8% annual coupons currently sells for \$1,105.94. Assuming a 30% marginal tax rate and an additional risk premium for equity relative to debt of 5%, the cost of equity using the bond-yield-plus-risk-premium approach is *closest* to:
- A. 9.9%
 - B. 12.0%
 - C. 13.0%

74. The following data apply to two comparable companies that are in direct competition.

	Company A	Company B
Times interest earned ratio	2.50	2.50
Return on equity (ROE)	10.13%	16.88%
Return on assets (ROA)	6.75%	11.25%
Asset turnover	1.50	2.50

Which of the following statements is *most* accurate?

- A. Company A has a higher degree of financial leverage than Company B.
 - B. Company A has a lower net profit margin.
 - C. Both companies have the same amount of interest expense.
75. When computing the cash flows for a capital project, which of the following is *least likely* to be included?
- A. Financing costs
 - B. Opportunity costs
 - C. Tax effects
76. The acceptance of which of the following capital budgeting projects is *most likely* to expose a company to the highest level of uncertainty?
- A. Replacement of worn out equipment
 - B. Newly launched product or services
 - C. Expansion projects

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77. Information-motivated traders are *most likely* to differ from pure investors in that they:
- A. pay lower transaction fees.
 - B. hold well-diversified portfolios.
 - C. expect to earn excess returns.
78. The index weighting that results in portfolio weights shifting away from securities that have increased in relative value toward securities that have fallen in relative value whenever the portfolio is rebalanced is *most* accurately described as:
- A. equal weighting.
 - B. fundamental weighting.
 - C. float-adjusted market-capitalization weighting.
79. The behavioral bias in which investors tend to avoid realizing losses but rather seek to realize gains is *best* described as:
- A. the gambler's fallacy.
 - B. the disposition effect.
 - C. mental accounting.

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80. A fund manager compiles the following data on two companies:

	Company A	Company B
Return on assets (ROA)	10.9%	9.0%
Return on equity (ROE)	15.4%	14.3%
Dividend payout ratio	0.35	0.30
Required rate of return	13.0%	12.4%
Weighted average cost of capital	11.8%	11.7%

The *best* conclusion the fund manager can make is that Company A's stock is more attractive than Company B's stock because of its:

- A. smaller price-to-earnings ratio (P/E).
 - B. higher dividend growth rate.
 - C. greater financial leverage.
81. A portfolio manager analyzes a market and discovers that it is not possible to achieve consistent and superior risk-adjusted returns, net of all expenses. This market is *most likely* characterized by:
- A. restrictions on short selling.
 - B. persistent anomalies.
 - C. informational efficiency.
82. An investor writes a put option on FTSE 100 Index futures. Which of the following *best* describes the investor's position with respect to the put contract and her exposure to the underlying index future, respectively?
- A. Short, long
 - B. Long, short
 - C. Short, short
83. If the number of financial analysts who follow or analyze a company increases substantially, then the market for this company's shares will *most likely* become:
- A. overvalued.

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- B. more efficient.
- C. more attractive for active investors.

84. Which of the following financial intermediaries is *most likely* to provide liquidity service to its clients?

- A. Exchanges
- B. Brokers
- C. Dealers

85. Which of the following statements is *least* accurate with respect to fixed-income indices?

- A. The indices are susceptible to turnover of the underlying securities.
- B. Compared with equity indices, it is easier and less expensive to replicate fixed-income indices.
- C. Many of the underlying securities in the index tend to be illiquid.

86. Which of the following statements concerning a security market index is *most* accurate?

- A. The divisor will be adjusted to prevent changes not related to prices of constituent securities.
- B. At inception, the total return version of an index will be greater than the price version of an index.
- C. Estimated market prices of constituent securities are not used to calculate the index value.

87. If the following three stocks are held in a portfolio, the portfolio's total return on an equal-weighted basis is *closest* to:

Stock	Number of Shares Owned	Beginning of Period Price per Share (\$)	End of Period Price per Share (\$)	Dividend per Share during the Period (\$)
A	500	40	37	2.00
B	320	50	52	1.50
C	800	30	34	0.00

- A. 6.37%.

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- B. 5.94%.
- C. 3.28%.

88. An analyst gathers the following information about a company's equity security:

- Trailing price-to-earnings multiple: 10x
- Last year's EPS: \$5.00
- Forecasted EPS growth rate: 10%

If the analyst estimates that the security is undervalued by \$4, the estimated intrinsic value is *closest* to:

- A. \$54.
- B. \$59.
- C. \$46.

89. Using put-call parity, a long call can *best* be replicated by going:

- A. long the put, short the asset and long the bond.
- B. long the put, long the asset and short the bond.
- C. short the put, long the asset and short the bond.

90. According to put-call-forward parity, if the put in a protective put with forward contract expires out of the money, the payoff is *most likely* equal to:

- A. zero.
- B. the face value of a risk-free bond.
- C. the market value of the underlying asset.

91. According to put-call parity, if a fiduciary call expires in the money, the payoff is *most likely* equal to the:

- A. market value of the asset.
- B. difference between the market value of the asset and the face value of the risk-free bond.
- C. face value of the risk-free bond.

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92. A high convenience yield is *most likely* associated with holding:
- A. commodities.
 - B. equities.
 - C. bonds.
93. According to put-call-forward parity, the difference between the price of a put and the price of a call is *most likely* equal to the difference between:
- A. forward price and spot price discounted at the risk-free rate.
 - B. exercise price and forward price discounted at the risk-free rate.
 - C. spot price and exercise price discounted at the risk-free rate.
94. In the binomial model, the difference between the up and down factors *best* represents the:
- A. moneyness of an option.
 - B. pseudo probability.
 - C. volatility of the underlying.
95. To obtain the spot yield curve, a bond analyst would *most likely* use the most:
- A. recently issued and actively traded government bonds.
 - B. seasoned and actively traded government bonds.
 - C. recently issued and actively traded corporate bonds.
96. What type of risk *most likely* affects an investor's ability to buy and sell bonds in the desired amounts and at the desired time?
- A. Default
 - B. Market liquidity
 - C. Spread

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97. The option-free bonds issued by ALS Corp. are currently priced at 108.50. Based on a portfolio manager's valuation model, a 1bp increase in interest rates will result in the bond price falling to 108.40, whereas a 1bp decrease in interest rates will result in the bond price rising to 108.59. The price value of a basis point (PVBp) for the bonds is *closest* to:
- A. 0.095.
 - B. 0.088.
 - C. 0.190.
98. The value of a 10-year, 6% coupon, \$100 par value bond with semiannual payments, assuming an annual discount rate of 7%, is *closest* to:
- A. \$99.07.
 - B. \$92.89.
 - C. \$107.44.
99. An investor sells a bond at the quoted price of \$98.00. In addition, she receives accrued interest of \$4.40. The flat price of the bond is equal to the:
- A. par value plus accrued interest.
 - B. agreed on bond price excluding accrued interest.
 - C. accrued interest plus the agreed on bond price.
100. A two-year spot rate of 5% is *most likely* the:
- A. yield to maturity on a coupon-paying bond maturing at the end of Year 2.
 - B. yield to maturity on a zero-coupon bond maturing at the end of Year 2.
 - C. coupon rate in Year 2 on a coupon-paying bond maturing at the end of Year 4.
101. The process of securitization is *least likely* to allow banks to:
- A. originate loans.
 - B. reduce the layers between borrowers and ultimate investors.
 - C. repackage loans into simpler structures.

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102. Consider a five-year option-free bond that is priced at a discount to par value. Assuming the discount rate does not change, one year from now the value of the bond will *most likely*:
- A. decrease.
 - B. stay the same.
 - C. increase.
103. An investor who owns a mortgage pass-through security is exposed to contraction risk which is the risk that when interest rates:
- A. decline, the security will effectively have a longer maturity than was anticipated at the time of purchase.
 - B. decline, the security will effectively have a shorter maturity than was anticipated at the time of purchase.
 - C. rise, the security will effectively have a shorter maturity than was anticipated at the time of purchase.
104. Which of the following *most likely* exhibits negative convexity?
- A. An option-free bond
 - B. A puttable bond
 - C. A callable bond
105. Consider two bonds that are identical except for their coupon rates. The bond that will have the highest interest rate risk *most likely* has the:
- A. lowest coupon rate.
 - B. highest coupon rate.
 - C. coupon rate closest to its market yield.
106. In a securitization structure, credit tranching allows investors to choose between:
- A. extension risk and contraction risk.
 - B. subordinated bonds and senior bonds.
 - C. partially amortizing loans and fully amortizing loans.

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107. The *most likely* impact of adding commodities to a portfolio of equities and bonds is to:
- A. increase risk.
 - B. reduce exposure to inflation.
 - C. provide higher current income.
108. Alternative investments that rely on estimates rather than observable market prices for valuation purposes are *most likely* to report:
- A. returns that are understated.
 - B. volatility of returns that is understated.
 - C. correlations of returns with the returns of traditional assets that are overstated.
109. Relative to traditional investments, alternative investments are *best* characterized as having:
- A. higher correlations with other asset classes.
 - B. unique legal and tax considerations.
 - C. greater liquidity.
110. The real estate index *most likely* to suffer from sample selection bias is a(n):
- A. REIT index.
 - B. appraisal index.
 - C. repeat sales index.
111. An investor whose portfolio lies to the right of the market portfolio on the capital market line (CML) has *most likely*:
- A. loaned some funds at the risk-free rate and invested the remaining funds in the market portfolio.
 - B. borrowed funds at the risk-free rate and invested all available funds in the market portfolio.
 - C. invested all available funds in the risk-free asset.

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112. A correlation matrix of the returns for securities A, B, and C is reported below:

Security	A	B	C
A	1		
B	0.5	1	
C	0	-0.5	1

Assuming that the expected return and the standard deviation of each security are the same, a portfolio consisting of an equal allocation of which two securities will be *most effective* for portfolio diversification?

- A. Securities A and B
- B. Securities B and C
- C. Securities A and C

113. Based on the capital asset pricing model (CAPM), the expected return on FGL Corp's shares is 12%. Using a model independent of the CAPM, an analyst has estimated the returns on the stock at 10%. Based on this information, the analyst is *most likely* to consider the stock to be:

- A. overvalued.
- B. correctly valued.
- C. undervalued.

114. Which of the following performance measures *most likely* relies on systematic risk as opposed to total risk when calculating a risk-adjusted return?

- A. Sharpe ratio
- B. M-squared
- C. Treynor ratio

115. The stock of GBK Corporation has a beta of 0.65. If the risk-free rate of return is 3% and the expected market return is 9%, the expected return for GBK is *closest* to:

- A. 3.9%.
- B. 6.9%.
- C. 10.8%.

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116. Stock X and Stock Y have the same level of total risk. Stock X has twice the systematic risk of Stock Y and half its non-systematic risk. Stock X's expected return will *most likely* be:

- A. lower than the expected return of Stock Y.
- B. the same as the expected return of Stock Y.
- C. higher than the expected return of Stock Y.

117. The strategic asset allocation and portfolio rebalancing policy are *most likely* addressed in which section of an investment policy statement?

- A. Procedures
- B. Appendices
- C. Investment objectives

118. Following its decision to divest its non-core assets, analysts expect HCL Corp's standard deviation of returns to rise to 30% and its correlation with the market portfolio to remain unchanged at 0.8. The risk-free rate and the market risk premium are expected to remain unchanged at 6% and 8%, respectively. However, the market portfolio's standard deviation of returns is expected to decrease to 15%. The firm's expected return after the restructure is *closest* to:

- A. 9.2%.
- B. 17.6%.
- C. 18.8%.

119. An asset management firm generated the following annual returns in their US large-cap equity portfolio:

Year	Net Return (%)
2008	−34.8
2009	32.2
2010	11.1
2011	−1.4

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The 2012 return needed to achieve a trailing five-year geometric mean annualized return of 5% when calculated at the end of 2012 is *closest* to:

- A. 17.9%.
- B. 27.6%.
- C. 35.2%.

120. The variance of returns of a security and the market portfolio are 0.25 and 0.09, respectively. If the covariance of security returns and market returns is 0.06, the security's beta is *closest* to:

- A. 0.40.
- B. 0.67.
- C. 0.24.

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