

2017 Level I Mock Exam: Afternoon Session

The afternoon 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. Richard Cardinal, CFA, is the founder of Volcano Capital Research, an investment management firm whose sole activity is short selling. Cardinal seeks out companies whose stocks have had large price increases. Cardinal also pays several lobbying firms to update him immediately on any legislative or regulatory changes that may impact his target companies. Cardinal sells short those target companies he estimates are near the peak of their sales and earnings and that his sources identify as facing legal or regulatory challenges. Immediately after he sells a stock, Cardinal conducts a public relations campaign to disclose all of the negative information he has gathered on the company, even if the information is not yet public. Which of Cardinal's actions is least likely to be in violation of the CFA Institute Standards of Professional Conduct?
 - A. Selling stock short
 - B. Trading on information from lobbyists
 - C. Disclosing information about target companies

2. Beth Kozniak, a CFA candidate, is an independent licensed real estate broker and a well-known property investor. She is currently brokering the sale of a commercial property on behalf of a client in financial distress. If the client's building is not sold within 30 days, he will lose the building to the bank. A year earlier, another client of Kozniak's had expressed interest in purchasing this same property. However, she is unable to contact this client, and she has not discovered any other potential buyers. Given her distressed client's limited time frame, Kozniak purchases the property herself and forgoes any sales commission. Six months later, she sells the property for a nice profit to the client who had earlier expressed interest in the property. Has Kozniak *most likely* violated the CFA Institute Standards of Professional Conduct?
 - A. Yes, she did not disclose her potential conflicts of interest to either client
 - B. Yes, she profited on the real estate to the detriment of her financially stressed client
 - C. No

3. Which of the following statements concerning the Global Investment Performance Standards (GIPS) is *most likely* correct?
 - A. The Standards eliminate the need for in-depth due diligence by investors.
 - B. Compliance with the Standards enhances the credibility of investment management firms.
 - C. Clients or prospective clients benefit from the Standards because the historical track record of compliant firms is accurate and precise.

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4. Monique Gretta, CFA, is a research analyst at East West Investment Bank. Previously, Gretta worked at a mutual fund management company and has a long-standing client relationship with the managers of the funds and their institutional investors. Gretta often provides fund managers, who work for Gretta's former employer, with draft copies of her research before disseminating the information to all of the bank's clients. This practice has helped Gretta avoid several errors in her reports, and she believes it is beneficial to the bank's clients, even though they are not aware of this practice. Regarding her research, Gretta *least likely* violated the CFA Institute Standards of Professional Conduct because:
- A. the long-standing client relationships are not disclosed.
 - B. this practice benefits all clients.
 - C. her report is a draft.
5. Belen Zapata, CFA, is the owner of Kawah Investments. Kawah promises investors returns of up to 12% per year and claims to achieve these returns by investing in non-investment-grade bonds and other fixed-income instruments. Over the next 12 months, bond market yields reach unprecedented lows and Zapata finds it impossible to achieve the returns she expected. No investments are ever made by Kawah, and clients are completely paid back all of their original investment. Zapata *most likely* violated the CFA Institute Standards of Professional Conduct because of the:
- A. investment mandate.
 - B. return of capital.
 - C. promised returns.
6. A central bank fines a commercial bank it supervises for not following statutory regulations regarding nonperforming loan provisions on three large loans as a result of the bank's loan provisioning policy. Louis Marie Buffet, CFA, sits on the board of directors of the commercial bank as a non-executive director, representing minority shareholders. He also chairs the bank's internal audit committee that determines the loan provisioning policy of the bank. Mercy Gatabaki, CFA, is the bank's external auditor and follows international auditing standards whereby she tests the loan portfolio by randomly selecting loans to check for compliance in all aspects of central bank regulations. Which charterholder is *most likely* in violation of the Code and Standards?
- A. Gatabaki
 - B. Buffet
 - C. Both

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7. Sergio Morales, CFA, believes he has found evidence that his supervisor is engaged in fraudulent activity involving a client's account. When Morales confronts his supervisor, he is told the client is fully aware of the issue. Later that day, Morales contacts the client and after disclosing the fraudulent activity, he is told by the client to mind his own business. Following the requirements of local law, Morales provides all of his evidence, along with copies of the client's most recent account statements, to a government whistleblower program. Has Morales *most likely* violated the CFA Institute Standards of Professional Conduct?
- A. Yes, concerning Duties to Employers
 - B. Yes, concerning Preservation of Confidentiality
 - C. No
8. According to the GIPS standards, for periods beginning on or after 1 January 2011, the aggregate fair value of total firm assets *most likely* includes all:
- A. fee- and non-fee-paying discretionary and non-discretionary accounts.
 - B. fee-paying discretionary accounts.
 - C. fee- and non-fee-paying discretionary accounts.
9. While at a bar in the financial district after work, Ellen Miffitt, CFA, overhears several employees of a competitor discuss how they will manipulate down the price of a thinly traded micro-cap stock's price over the next few days. Miffitt's clients have large positions of this stock, so when she arrives at work the next day, she immediately sells all of these holdings. Because she had determined the micro-cap stock was suitable for all of her accounts at its previously higher price, Miffitt buys back her client's original exposure at the end of the week at the new, lower price. Which CFA Institute Standards of Professional Conduct did Miffitt *least likely* violate?
- A. Material Nonpublic Information
 - B. Preservation of Confidentiality
 - C. Market Manipulation

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10. Pia Nilsson is a sole proprietor investment adviser. An economic recession has reduced the number of clients she advises and caused revenues to decline. As a result, Nilsson has not paid her CFA Institute membership dues for the past two years. When a national financial publication recently interviewed Nilsson, she indicated that up until two years ago, she had been a CFA charterholder and a CFA Institute member in good standing. In addition, she stated the completion of the CFA Program enhanced her portfolio management skills and enabled her to achieve superior returns on behalf of her clients. Which of Nilsson's actions *most likely* violated the CFA Institute Standards of Professional Conduct?
- A. Nonpayment of CFA Institute membership dues
 - B. Indicating that being a CFA charterholder has enhanced her portfolio management skills
 - C. Attributing her superior returns to participation in the CFA Program
11. Molly Burnett, CFA, is a portfolio manager for a fund that only invests in environmentally friendly companies. A multinational utility company recently acquired one of the fund's best-performing investments, a wind power company. The wind power company's shareholders received utility company shares as part of the merger agreement. The utility has one of the worst environmental records in the industry, but its shares have been one of the top performers over the past 12 months. Because the utility pays a high dividend every three months, Burnett holds the utility shares until the remaining two dividends are paid for the year then sells the shares. Burnett *most likely* violated the CFA Institute Standard of Professional Conduct concerning:
- A. Independence and Objectivity.
 - B. Suitability.
 - C. Disclosure of Conflicts.
12. Gabrielle Gabbe, CFA has been accused of professional misconduct by one of her competitors. The allegations concern Gabbe's personal bankruptcy filing 10 years ago when she was a college student and had a large amount of medical bills she could not pay. By not disclosing the bankruptcy filing to her clients, did Gabbe *most likely* violate any CFA Institute Standards of Professional Conduct?
- A. No
 - B. Yes, related to Misrepresentation
 - C. Yes, related to Misconduct

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13. Francesca Ndenda, CFA, and Grace Rutabingwa work in the same department for New Age Managers, with Rutabingwa reporting to Ndenda. Ndenda learns that Rutabingwa received a Notice of Enquiry from the Professional Conduct Program at CFA Institute regarding a potential cheating violation when she sat for the CFA exam in June. As Rutabingwa's supervisor, Ndenda is afraid that Rutabingwa's behavior will be seen as a violation of the Code and Standards. Does Ndenda *most likely* have cause for concern?
- A. Yes
 - B. No, because her responsibilities do not apply
 - C. No, not until Rutabingwa is found guilty of cheating
14. Which of the following statements concerning why the Global Investment Performance Standards (GIPS) were created is *least likely* correct? The GIPS standards were created to:
- A. establish a standardized, industry wide approach for investment firms to follow.
 - B. provide clients certainty in what is presented and allow them to make reasonable comparisons.
 - C. identify a set of ethical principles for firms to follow in calculating and presenting historical investment results.
15. Chan Liu, CFA, is the new research manager at the Pacific MicroCap Fund. Liu observed the following activities after she published a research report on a thinly traded micro-cap stock that included a "buy" recommendation:
- Pacific traders purchased the stock for Pacific's proprietary account and then purchased the same stock for all client accounts; and
 - Pacific marketing department employees disseminated positive, but false, information about the stock in widely read internet forums.
- Liu notes the stock's price increased more than 50% within a period of two days and was then sold for Pacific's account. Which of the following steps is most appropriate for Liu to take to avoid violating the CFA Institute Standards of Professional Conduct?
- A. Remove her name from the micro-cap stock research report.
 - B. Report the observed activities to her employer.
 - C. Publicly refute the false information posted on internet forums.

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16. Mariam Musa, CFA, head of compliance at Dunfield Brokers, questions her colleague Omar Kassim, a CFA candidate and a research analyst, about his purchase of shares in a company for his own account immediately before he publishes a "buy" recommendation. He defends his actions by stating he has done nothing wrong because Dunfield does not have any personal trading policies in place. The CFA Institute Standards of Professional Conduct were most likely violated by:
- A. only Musa.
 - B. only Kassim.
 - C. both Musa and Kassim.
17. James Simone, CFA, the chief financial officer of a publicly listed company, seeks to improve the quality of his company's communication with institutional fund managers. He holds an investor briefing with this group the evening before the company earnings are announced. The company's quarterly earnings are broadcast in a press release the next day before the market opens. The earnings information in the investor briefing is identical to that in the press release. Did Simone *most likely* violate the CFA Institute Standards of Professional Conduct?
- A. Yes
 - B. No, because the company releases information while the market is closed
 - C. No, because investor briefing and press release information are identical
18. Kirsten Kelso, CFA, is a research analyst at an independent research firm. Kelso is part of a team of analysts who focus on the automobile industry. Recently, Kelso disagreed with two research sell recommendations written by her team, even though she felt confident the research process was properly conducted. In a webcast open to all institutional but not retail clients, Kelso states, "Even though my name is on the sell reports, these stocks are a buy in part because sales and share prices for both auto companies will rise significantly because of strong demand for their vehicles." Kelso's actions would *least likely* violate which of the following CFA Institute Standards of Professional Conduct?
- A. Communication with Clients
 - B. Diligence and Reasonable Basis
 - C. Fair Dealing

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19. Samples of size (n_1, n_2) are drawn respectively from two populations (X_1, X_2) with associated sample means and standard deviations of (\bar{X}_1, \bar{X}_2) and (s_1, s_2) and associated population means and standard deviations of (μ_1, μ_2) and (σ_1, σ_2) where $\sigma_1 \neq \sigma_2$. In addition, \bar{d} is the sample mean of $X_1 - X_2$ with a standard error of $s_{\bar{d}}$ and a population mean of μ_{d0} and s_p^2 is a pooled estimator of the common variance.

The *most* appropriate test statistic to determine the equality of the two population means assuming X_1 and X_2 are independent and normally distributed is:

- A.
$$t = \frac{(\bar{X}_1 - \bar{X}_2) - (\mu_1 - \mu_2)}{\left(\frac{s_p^2}{n_1} + \frac{s_p^2}{n_2}\right)^{0.5}}$$
- B.
$$t = \frac{(\bar{X}_1 - \bar{X}_2) - (\mu_1 - \mu_2)}{\left(\frac{s_1^2}{n_1} + \frac{s_2^2}{n_2}\right)^{0.5}}$$
- C.
$$t = \frac{\bar{d} - \mu_{d0}}{s_{\bar{d}}}$$

20. Using a two-tailed test of the hypothesis that the population mean is zero, the calculated test statistic is 2.51. The sample has 23 observations. The population is normally distributed with an unknown variance.

Degrees of freedom	$p = 0.10$	$p = 0.05$	$p = 0.025$	$p = 0.01$	$p = 0.005$
21	1.323	1.721	2.080	2.518	2.831
22	1.321	1.717	2.074	2.508	2.819
23	1.319	1.714	2.069	2.500	2.807
24	1.318	1.711	2.064	2.492	2.797

An analyst will *most likely* reject the null hypothesis at significance levels of:

- A. 0.10, 0.05, and 0.01.
 B. 0.10 and 0.05.
 C. 0.10 only.

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21. Independent samples drawn from normally distributed populations exhibit the following characteristics:

Sample	Size	Sample Mean	Sample Standard Deviation
A	25	200	45
B	18	185	60

Assuming that the variances of the underlying populations are equal, the pooled estimate of the common variance is 2,678.05. The t -test statistic appropriate to test the hypothesis that the two population means are equal is *closest* to:

- A. 0.29.
 - B. 0.94.
 - C. 1.90.
22. Once an investor chooses a particular course of action, the value forgone from alternative actions is *best* described as a(n):
- A. opportunity cost.
 - B. sunk cost.
 - C. required return.
23. The central limit theorem is *best* described as stating that the sampling distribution of the sample mean will be approximately normal for large-size samples:
- A. if the population distribution is symmetrical.
 - B. for populations described by any probability distribution.
 - C. if the population distribution is normal.
24. Survivorship bias is *most likely* an example of which bias?
- A. Look-ahead
 - B. Data mining
 - C. Sample selection

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25. If a stock's continuously compounded return is normally distributed, then the distribution of the future stock price is *best* described as being:
- A. normal.
 - B. lognormal.
 - C. a Student's *t*.
26. The distribution of all the distinct possible values for a statistic when calculated from samples of the same size randomly drawn from the same population is *most* accurately referred to as:
- A. the sampling distribution of a statistic.
 - B. a discrete uniform distribution.
 - C. a multivariate normal distribution.
27. Compared with historical simulation, Monte Carlo simulation is *most* appropriate when:
- A. "what if" analysis is required.
 - B. analytical methods are required.
 - C. probability distributions are unavailable.

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28. Consider a two-tailed test of the hypothesis that the population mean is zero. The sample has 50 observations. The population is normally distributed with a known variance.

t-Distribution			
Degrees of freedom	$p = 0.10$	$p = 0.05$	$p = 0.025$
49	1.299	1.677	2.010
50	1.299	1.676	2.009
z-Distribution	$\alpha = 0.10$	$\alpha = 0.05$	$\alpha = 0.025$
	1.645	1.960	2.330

At a 0.05 significance level, the rejection points are *most likely* at:

- A. -2.010 and 2.010.
 - B. -2.009 and 2.009.
 - C. -1.960 and 1.960.
29. A hypothesis test fails to reject a false null hypothesis. This result is *best* described as a:
- A. test with little power.
 - B. Type II error.
 - C. Type I error.
30. A sample of 25 observations has a mean of 8 and a standard deviation of 15. The standard error of the sample mean is *closest* to:
- A. 3.00.
 - B. 1.60.
 - C. 3.06.

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31.

	Population 1	Population 2
Sample size	$n_1 = 5$	$n_2 = 5$
Sample variance	$s_1^2 = 4$	$s_2^2 = 28$
The samples are drawn independently and both populations are assumed to be normally distributed.		

Using the above data, an analyst is trying to test the null hypothesis that the population variances are equal ($H_0: \sigma_1^2 = \sigma_2^2$) against the alternative hypothesis that the variances are not equal ($H_a: \sigma_1^2 \neq \sigma_2^2$) at the 5% level of significance. The following table provides the F -distribution.

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Table of the F-Distribution						
<i>Panel A: Critical values for right-hand tail area equal to 0.05</i>						
	df1 (read across)	1	2	3	4	5
df2 (read down)	1	161	200	216	225	230
	2	18.5	19.0	19.2	19.2	19.3
	3	10.1	9.55	9.28	9.12	9.01
	4	7.71	6.94	6.59	6.39	6.26
	5	6.61	5.79	5.41	5.19	5.05
<i>Panel B: Critical values for right-hand tail area equal to 0.025</i>						
	df1 (read across)	1	2	3	4	5
df2 (read down)	1	648	799	864	900	922
	2	38.51	39.00	39.17	39.25	39.30
	3	17.44	16.04	15.44	15.10	14.88
	4	12.22	10.65	9.98	9.60	9.36
	5	10.01	8.43	7.76	7.39	7.15

Which of the following statements is *most* appropriate? The critical value is:

- A. 9.60 and do not reject the null.
- B. 6.39 and reject the null.
- C. 7.15 and do not reject the null.

32. The confidence interval is *most likely* to be:

- A. wider as the sample size increases.
- B. wider as the point estimate increases.
- C. narrower as the reliability factor decreases.

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33. First-degree price discrimination is *best* described as pricing that allows producers to increase their economic profit while consumer surplus:

- A. decreases.
- B. is eliminated.
- C. increases.

34. The following data apply to a country in its domestic currency units:

Consumer spending on goods and services	875,060	Government spending on goods and services	305,600
Business gross fixed investment	286,400	Government gross fixed investment	84,120
Change in inventories	-68,500	Capital consumption allowance	8,540
Transfer payments	9,300	Statistical discrepancy	-2,850
Exports	219,800	Imports	250,980

Using the expenditures approach, the country's GDP is *closest* to:

- A. 1,466,490.
- B. 1,448,650.
- C. 1,451,500.

35. For a given economy and a given period of time, GDP measures the:

I.	aggregate income earned by all households, all companies, and the government.
II.	total income earned by all of the country's citizens, firms, and the government.
III.	total market value produced of resalable and final goods and services.

The *most* appropriate description of what is measured by GDP is given by:

- A. I and III.
- B. I only.
- C. I and II.

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36. In the short run, a firm operating in a perfectly competitive market will *most likely* avoid shutdown if it is able to earn sufficient revenue to cover which of the following costs?
- A. Fixed
 - B. Variable
 - C. Marginal
37. Assume that two firms in a duopoly enter into a collusive agreement in an attempt to form a cartel and restrict output, raise prices, and increase profits. According to the Nash equilibrium, a low price is *most likely* charged by:
- A. neither firm.
 - B. only one firm.
 - C. both firms.

38.

	Spot Rate	Expected Spot Rate in One Year
USD/EUR	1.3001	1.3456
USD/GBP	1.5805	1.5489

Based on the table, the appreciation of which of the following currencies is *most likely* to occur?

- A. The British pound against the US dollar by 2.00%
 - B. The euro against the US dollar by 3.50%
 - C. The US dollar against the euro by 3.38%
39. Given the inverse demand function $P_x = 13 - 3.7Q_x$, where P_x is the price per unit of good X and Q_x is the quantity demanded of good X, in units, the maximum value for Q_x is *closest* to:
- A. 9.3.
 - B. 3.5.
 - C. 13.0.

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40. A country with which of the following characteristics is *least likely* to face long-term GDP growth challenges?

- A. A country with innovations in production processes
- B. A country with large natural resources
- C. A country with high labor quality

41.

	Spot Rate	One-Year Forward Rate
USD/EUR	1.2952	1.3001

Which of the following statements is *most* accurate based on the FX quotations in the table?





- A. The euro is trading at a forward premium of 49 points.
- B. The forward rate is trading at a discount to the spot rate by 0.0049 points.
- C. The US dollar is trading at a forward premium of 49 points.

42. In the demand function $Q_x^d = 4.3 - 0.7P_x + .03I - .05P_y$, where Q_x^d represents the quantity demanded of a good X, P_x is the price per unit of good X, I is consumers' income, and P_y is the price per unit of good Y, X, and Y are *best* described as:

- A. complements.
- B. substitutes.
- C. preferences.

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43. In a simple economy with no foreign sector, the following equations apply:

Consumption function	
Investment function	
Government spending	
Tax function	
Y: aggregate income r: real interest rate in percent	

If the real interest rate is 3% and government spending increases to 2,000, the increase in aggregate income will be *closest* to:

- A. 5,000.
- B. 7,143.
- C. 5,845.

44. Which of the following would be *most* useful as a leading indicator to signal the start of an economic recovery?

- A. The narrowing of the spread between the 10-year Treasury yield and the federal funds rate
- B. An increase in aggregate real personal income (less transfer payments)
- C. A decrease in average weekly initial claims for unemployment insurance

45. A company values its ending inventory using the prices of its most recent purchases. The inventory valuation method that the company is *most likely* using is:

- A. LIFO.
- B. FIFO.
- C. Weighted average cost.

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46. If a company capitalizes an expenditure related to capital assets instead of expensing it, ignoring taxes, the company will *most likely* report:
- A. the same free cash flow to the firm (FCFF) in that period.
 - B. a lower cash flow per share in that period.
 - C. a higher earnings per share in future periods.
47. To evaluate the potential effect of an innovative and unique type of business transaction on financial statements, an analyst's *best* approach is to:
- A. gain an understanding of the transaction's economic purpose.
 - B. consider the approach taken for "new" transactions that arose in the past.
 - C. monitor the actions of standard setters and regulators.
48. Operating segments are *most likely* reportable if they constitute 10% or more of the total for all operating segments of which financial metrics?
- A. Capital expenditures, liabilities, or profit/loss
 - B. Amortization expense, assets, or revenue
 - C. Assets, profit/loss, or revenue
49. Which of the following is *least likely* to be an acceptable approach for accounting standard setting bodies to use when developing accounting standards?
- A. Objectives-oriented
 - B. Rules-based
 - C. Revenue/expense-based
50. Net revenue *most likely* refers to revenue minus:
- A. volume discounts and estimated returns.
 - B. revenues attributable to non-controlling interests.
 - C. estimates of warranty expense.

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51. Analysts can *best* address the challenges of comparing financial statements prepared under US GAAP with those prepared under International Financial Reporting Standards (IFRS) by:
- A. monitoring changes in both sets of standards and interpreting cautiously.
 - B. assuming differences are minor given US GAAP and IFRS convergence.
 - C. referring to the reconciliation from IFRS to US GAAP provided in the notes.
52. Compared with the management discussion and analysis (MD&A), notes to the financial statements are the *most* appropriate source for:
- A. aspects of accounting policy choices most important to understanding the financial statements.
 - B. information on capital expenditures and how they support the entity's strategic direction.
 - C. a comprehensive description of all of the entity's accounting policy choices.
53. Under IFRS it is *most* appropriate to include which of the following pension costs of a defined benefit plan in other comprehensive income?
- A. Actuarial gains or losses
 - B. Employees service cost
 - C. Net interest expense accrued on the beginning net pension liability
54. The following relates to a company's common equity over the course of the year:

Outstanding shares, at start of the year	2,000,000
Stock options outstanding, at start and end of the year (Exercise price: \$5)	100,000
Shares issued on 1 April	300,000
Shares repurchased (treasury shares) on 1 July	100,000
Average market price of common shares for the year	\$20/share

If the company's net income for the year is \$5,000,000, its diluted EPS is *closest* to:

- A. \$2.22.

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- B. \$2.20.
- C. \$2.17.

55.

(£ millions)	2014	2013
Accounts receivable, gross	6,620	4,840
Allowance for doubtful accounts	92	56
Write-offs during the year	84	42

Based on the presented information about a company's trade receivables, the bad debt expense (in £ millions) for 2014 is *closest* to:

- A. 84.
 - B. 120.
 - C. 36.
56. For a company that prepares its financial statements under IFRS, for which of the following assets is it *most likely* that it could report using the fair value model?
- A. A building owned by the company and leased out to tenants
 - B. Houses built by the company for sale to customers
 - C. A building the company owns and uses to house its administrative activities

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57. The following common-size income statement data and tax rates are available on a company.

Financial Item	Current Year (%)
Revenues	100
Cost of goods sold	38.6
Interest expense	3.1
Research expenses	4.4
Selling and general expenses	32.9
Income tax rate	22%
Prior Year's Profitability Ratios	
Gross profit margin	60.5%
Operating profit margin	23.3%
Net profit margin	15.8%

The profitability ratio that had the *largest* absolute increase in value in the current year is the:

- A. operating profit margin.
- B. gross profit margin.
- C. net profit margin.

58. Which of the following *best* describes a responsibility of the SEC?

- A. Promoting the adoption of global financial reporting standards
- B. Overseeing the Public Companies Accounting Oversight Board (PCAOB)
- C. Prosecuting analysts who disseminate conclusions based on non-material non-public information

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59. Selected information from a company's comparative income statement and balance sheet is presented below:

Selected Income Statement Data for the Year Ended 31 August (\$ thousands)		
	2013	2012
Sales revenue	100,000	95,000
Cost of goods sold	47,000	47,500
Depreciation expense	4,000	3,500
Net Income	11,122	4,556

Selected Balance Sheet Data as of 31 August (\$ thousands)		
	2013	2012
Current Assets		
Cash and investments	21,122	25,000
Accounts receivable	25,000	13,500
Inventories	<u>13,000</u>	<u>8,500</u>
Total current assets	59,122	47,000
Current liabilities		
Accounts payable	15,000	15,000
Other current liabilities	<u>7,000</u>	<u>9,000</u>
Total current liabilities	22,000	24,000

The cash collected from customers in 2013 is *closest* to:

- A. \$111,500.
- B. \$96,100.
- C. \$88,500.

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60. Along with relevance, the *most* critical qualitative characteristic of financial information is:
- A. faithful representation.
 - B. comparability.
 - C. understandability.
61. One of the notable differences between IFRS and US GAAP when dealing with income tax is *best* illustrated by the fundamental treatment of:
- A. temporary differences between the carrying amount and tax base of assets and liabilities.
 - B. non-deductible goodwill.
 - C. the revaluation of property, plant and equipment.
62. The *best* description of a classified statement of financial position is one that:
- A. distinguishes between current and non-current assets and liabilities.
 - B. is supported by note disclosures relevant to understanding its components.
 - C. has not been audited.
63. The objective of general purpose financial reporting is *best* described as:
- A. facilitating resource allocation decisions by current and potential investors and creditors.
 - B. reporting an entity's economic resources and claims, and changes therein, to shareholders.
 - C. providing information about financial performance to a wide range of users.
64. A company acquires some new depreciable assets. It uses straight-line depreciation for all of its assets. Which of the following combinations of estimated residual values and useful lives is *most likely* to produce the highest net profit margin? Estimated residual values should be:
- A. high with long average lives.
 - B. high with short average lives.
 - C. low with long average lives.

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65. Income statements for two companies (A and B) and the common-size income statement for the industry are provided in the following table:

(\$ thousands)	Company A	Company B	Industry
Sales	\$10,500	\$8,250	100.0%
Cost of goods sold	6,353	5,239	62.8%
Selling, general, and administrative expenses	2,625	2,021	24.8%
Interest expense	840	536	7.0%
Pretax earnings	683	454	5.4%
Taxes	205	145	1.7%
Net earnings	\$478	\$309	3.7%

The *best* conclusion an analyst can make is that:

- A. Company A earns a higher gross margin than both Company B and the industry.
 - B. both companies' tax rates are higher than the industry average.
 - C. Company B's interest rate is lower than the industry average.
66. The role of the International Organization of Securities Commissions (IOSCO) is *best* described as:
- A. promoting the use of International Financial Reporting Standards and the convergence of national accounting standards.
 - B. enforcing financial reporting requirements for entities participating in capital markets.
 - C. promoting cross-border cooperation and uniformity in securities regulation.
67. The SEC's approach to addressing the significant differences in financial reporting under International Financial Reporting Standards (IFRS) and US GAAP is *best* described as:
- A. mandating that non-US issuers provide a reconciliation to US GAAP.
 - B. requiring issuers to provide disclosures describing key differences.
 - C. publicly advocating for global accounting standards and convergence.

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68. The method a high-end custom-built motorcycle manufacturer uses to value its inventory results in the matching of the physical flow of the particular items sold, and the items remaining in inventory, to their actual cost. Which of the following inventory valuation methods is the manufacturer *most likely* using?

- A. FIFO
- B. Specific identification
- C. Weighted average cost

69. Which of the following dates in the dividend chronology can fall on a weekend? The

- A. payment date.
- B. ex-date.
- C. record date.

70. The following information is available for a firm:

Sales price per unit	€85
Variable cost per unit	€65
Fixed operating costs	€50 million
Fixed financial costs	€30 million

The firm's breakeven quantity of sales (in million units) is *closest* to:

- A. 1.0.
- B. 2.5.
- C. 4.0.

71. Financial risk is *least likely* affected by:

- A. long-term leases.
- B. dividends.
- C. debentures.

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72. A company's optimal capital budget *most likely* occurs at the intersection of the:
- A. marginal cost of capital and investment opportunity schedule.
 - B. marginal cost of capital and net present value profiles.
 - C. net present value and internal rate of return profiles.
73. A company has decided to switch to using accelerated depreciation from straight-line depreciation. Holding other factors constant, the degree of total leverage (DTL) will *most likely*:
- A. increase.
 - B. not change.
 - C. decrease.

74. The following information is available for a company's bank account:

Total deposits (millions)	\$16.0
Average daily float (millions)	\$2.5
Number of days	15

The float factor for the company is *closest* to:

- A. 6.4.
 - B. 2.3.
 - C. 0.4.
75. Which method of calculating the firm's cost of equity is most likely to incorporate the long-run return relationship between the firm's stock and the market portfolio?
- A. Capital asset pricing model
 - B. Dividend discount model
 - C. Bond yield plus risk premium approach

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76. A company decides to repurchase 5 million of its outstanding 20 million shares with debt funding. After the repurchase, the company's after-tax earnings decline by 20%. The new earnings per share (EPS) is *most likely*:
- A. less than the pre-repurchase EPS.
 - B. greater than the pre-repurchase EPS.
 - C. equal to the pre-repurchase EPS.
77. The following data pertain to a company that can be appropriately valued using the Gordon growth model. The dividend is expected to grow indefinitely at the existing sustainable growth rate.

EPS growth rate (three-year average)	7.50%
Current dividend per share	\$3.00
Return on equity	15%
Dividend payout ratio	45%
Investors' required rate of return	16%

The stock's intrinsic value is *closest* to:

- A. \$41.90.
 - B. \$37.94.
 - C. \$34.62.
78. Which of the following statements about the forms of market efficiency is *least* accurate? If the form of market efficiency is:
- A. semi-strong, then security prices fully reflect all past market data.
 - B. weak, then investment strategies based on fundamental analysis could achieve abnormal returns.
 - C. strong, then prices reflect only private information.

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79. The following table shows information on three different investment strategies with equivalent systematic risk:

		Annualized Data	
Strategy	Type of Strategy	Fees and Expenses	Net Return
1	Passive	0%	15%
2	Exploits price patterns	1%	14%
3	Uses fundamental analysis	2%	

The return, gross of fees and expenses that causes Strategy 3 to be *most* consistent with the strong form of market efficiency is:

- A. 16%.
 - B. 18%.
 - C. 17%.
80. The voting rights of an unsponsored depository receipt (DR) belong to the:
- A. direct owners of the foreign common shares.
 - B. foreign company whose shares are held by the depository.
 - C. depository bank.
81. A trader is able to obtain persistent abnormal returns by adopting an investment strategy that purchases stocks that have recently experienced high returns. This strategy exploits a market-pricing anomaly *best* described as:
- A. the overreaction effect.
 - B. data mining.
 - C. momentum.
82. Security market indices can be used to calculate alphas, which are *best* described as:
- A. the systematic risk of a security, using the index as a proxy for the entire market.

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- B. the difference between the return of the actively managed portfolio and the return of the passive portfolio.
 - C. a measure of market sentiment.
83. If a test rejects the hypothesis that market prices reflect private information but does not reject the hypothesis that they reflect past market data and public information, then the form of market efficiency is *best* described as:
- A. strong.
 - B. weak.
 - C. semi-strong.
84. A trader buys 500 shares of a stock on margin at \$36 a share using an initial leverage ratio of 1.66. The maintenance margin requirement for the position is 30%. The stock price at which the margin call will occur is *closest* to:
- A. \$20.57.
 - B. \$25.20.
 - C. \$30.86.
85. Compared with unregulated markets, regulated markets are *best* characterized by:
- A. reduced arbitrage opportunities.
 - B. higher transaction costs.
 - C. lower trading volumes.

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86. An investor gathers the following data to estimate the intrinsic value of a company's stock using the justified forward price-to-earnings ratio (P/E) approach.

Next year's earnings per share	\$3.00
Return on equity	12.5%
Dividend payout ratio	60%
Required return on shares	10%

The intrinsic value per share is *closest* to:

- A. \$72.
 - B. \$48.
 - C. \$36.
87. An analyst will *most likely* put a "sell" recommendation on a stock when its:
- A. market value is lower than fundamental value.
 - B. market value is higher than intrinsic value.
 - C. intrinsic value is positive.
88. Compared with public equity markets, which of the following statements is *most* accurate about private equity markets? Operating in the private market:
- A. offers stronger incentives to improve corporate governance.
 - B. allows management to better adopt a long-term focus.
 - C. allows more opportunities to raise capital.
89. Conceptually, a FRA *most likely* allows a company that wants to invest money in the future to lock in a rate by making a:
- A. variable payment and receiving a fixed payment.
 - B. fixed payment and receiving a different fixed payment.
 - C. fixed payment and receiving a variable payment.

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90. During its life, the value of a forward contract is *most likely* equal to the price of the underlying minus the price of the:
- A. forward, discounted over the remaining term of the contract.
 - B. forward.
 - C. forward, discounted over the original term of the contract.
91. Forward rate agreements are *most likely* used to hedge an exposure in the:
- A. foreign exchange market.
 - B. money market.
 - C. equity market.
92. A corporation issues five-year fixed-rate bonds. Its treasurer expects interest rates to decline for all maturities for at least the next year. She enters into a one-year agreement with a bank to receive quarterly fixed-rate payments and to make payments based on floating rates benchmarked on three-month LIBOR. This agreement is *best* described as a:
- A. futures contract.
 - B. swap.
 - C. forward contract.
93. Which of the following statements is *least* accurate concerning differences in the pricing of forwards and futures?
- A. Interest rate volatility can explain pricing differences.
 - B. Pricing differences can arise if futures prices and interest rates are uncorrelated.
 - C. Differences in the pattern of cash flows of forwards and futures can explain pricing differences.
94. A forward rate agreement *most likely* differs from most other forward contracts, because:
- A. its underlying is not an asset.
 - B. positions cannot be closed out prior to maturity.
 - C. it involves an option component.

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95. Which of the following statements is *least* accurate regarding the factors that affect the interest rate risk characteristics of an option-free bond?
- A. The longer the bond's maturity, the greater the bond's price sensitivity to changes in interest rates.
 - B. The lower the coupon rate, the greater the bond's price sensitivity to changes in interest rates.
 - C. The higher the yield, the greater the bond's price sensitivity to changes in interest rates.
96. Centro Corp. recently issued a floating-rate note (FRN) that includes a feature that prevents its coupon rate from falling below a prespecified minimum rate. This feature in an FRN is *most likely* referred to as a:
- A. cap.
 - B. floor.
 - C. collar.
97. If the yield-to-maturity on an annual-pay bond is 7.75%, the bond-equivalent yield is *closest* to:
- A. 7.90%.
 - B. 8.05%.
 - C. 7.61%.
98. A South Korean electronics company issued bonds denominated in US dollars in the United States and registered with the SEC. These bonds are *most likely* known as a:
- A. foreign bond.
 - B. global bond.
 - C. eurobond.
99. Consider a \$100 par value bond, with an 8% coupon paid annually, maturing in 20 years. If the bond currently sells for \$96.47, the yield to maturity is *closest* to:
- A. 8.37%.

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- B. 8.29%.
- C. 7.41%.

100. Consider bonds that have the same yield to maturity and maturity. The bond with the greatest reinvestment risk is *most likely* the one selling at:

- A. par.
- B. a discount.
- C. a premium.

101. A 90-day commercial paper issue is quoted at a discount rate of 4.75% for a 360-day year. The bond equivalent yield for this instrument is *closest* to:

- A. 4.87%.
- B. 4.75%.
- C. 4.81%.

102. In a rising interest rate environment, the effective duration of a puttable bond relative to an otherwise identical non-puttable bond, will *most likely* be:

- A. higher.
- B. lower.
- C. the same.

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103. A credit analyst observes the following information for Zeta Corp. and its industry.

	Zeta Corp.	Industry Median
Return on capital (%)	19.0%	20.0%
Total debt/Total capital (%)	42.0%	15.5%
FFO/Total debt (%)	45.3%	40.0%
Total debt/EBITDA (x)	3.5x	1.2x
EBITDA interest coverage (x)	4.0x	7.5x

Based on this information, it is *most likely* that the credit risk of Zeta Corp. is:

- A. below its industry peers.
- B. above its industry peers.
- C. similar to its industry peers.

104. Which of the following is *least likely* a component of yield spread?

- A. Expected inflation rate
- B. Taxation
- C. Credit risk

105. Which of the following 90-day money market instruments *most likely* offers the investor the highest rate of return?

Money Market Instrument	Quoted Rate	Quotation Basis	Day Convention
Instrument A	5.78%	360	Discount rate
Instrument B	5.80%	365	Discount rate
Instrument C	5.96%	365	Add-on rate

- A. Instrument C
- B. Instrument A
- C. Instrument B

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106. Using the following US Treasury forward rates, the value of a 2½-year \$100 par value Treasury bond with a 5% coupon rate is *closest* to:

Period	Years	Forward Rate
1	0.5	1.20%
2	1	1.80%
3	1.5	2.30%
4	2	2.70%
5	2.5	3.00%

- A. \$104.87.
- B. \$106.83.
- C. \$101.52.

107. Illiquidity is *most likely* a major concern when investing in:

- A. private equity.
- B. real estate investment trusts.
- C. commodities.

108. Do management fees *most likely* get paid to the manager of a hedge fund, regardless of the fund's performance?

- A. No, only when the fund's net asset value exceeds the previous high-water mark
- B. No, only when the fund's gross return is positive
- C. Yes

109. Concentrated portfolio strategies are attractive because of their:

- A. potential to generate alpha.
- B. ability to track market indices.

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C. low risk.

110. Compared with other investment asset classes, an investment in real estate is *least likely* to be characterized by:

- A. basic indivisibility.
- B. homogeneity.
- C. fixed location.

111. In the context of strategic asset allocation, adding asset classes with low correlation will *most likely* improve a portfolio's risk-return trade-off as long as the stand-alone risk of the added asset class:

- A. does not exceed its diversification effect.
- B. equals its diversification effect.
- C. exceeds its diversification effect.

112. You are preparing an investment policy statement for a client who manages her own successful marketing consultancy. Her annual income is approximately \$500,000. She describes herself as a finance novice. Most of her savings are invested in bank term deposits and short-term government securities. In her responses to the standard risk assessment questionnaire, she strongly agrees with the statements that she "feels more comfortable putting money in a bank account than in the stock market." Also, she "thinks of the word 'risk' as being a 'loss'". Based on this information, your client's ability and willingness to take risk can best be described as:

- A. high ability and low willingness.
- B. high ability and willingness.
- C. low ability and high willingness.

113. A key difference between a wrap account and a mutual fund is that wrap accounts:

- A. have assets that are owned directly by the individual.
- B. cannot be tailored to the tax needs of a client.
- C. have a lower required minimum investment.

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114. Which of the following is *least likely* an assumption of the capital asset pricing model (CAPM)?
- A. Investors are different only with respect to their unique holding periods.
 - B. An investor can invest as much as he or she desires in any asset.
 - C. Security prices are not affected by investor trades.
115. If Investor A has a lower risk aversion coefficient than Investor B, on the capital allocation line, will Investor B's optimal portfolio *most likely* have a higher expected return?
- A. No, because Investor B has a higher risk tolerance
 - B. No, because Investor B has a lower risk tolerance
 - C. Yes
116. The return measure that *best* allows one to compare asset returns earned over different length time periods is the:
- A. annualized return.
 - B. net portfolio return.
 - C. holding period return.
117. Based on the following historical data, which is *closest* to the standard deviation for the two-asset portfolio shown in the table?

	Asset A	Asset B	Asset A and B
Standard deviation	4.7%	7.7%	
Portfolio weight	0.4	0.6	
Correlation			0.3

- A. 6.5%
- B. 5.5%

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C. 5.0%

118. When considering a portfolio that is optimal for one investor, a second investor with a higher risk aversion would *most likely*:

- A. expect a higher variance for the portfolio.
- B. derive a lower utility from the portfolio.
- C. have a lower return expectation for the portfolio.

119. A portfolio has the following returns:

	Portfolio Returns
2006	2.4%
2007	9.6%
2008	-4.0%
2009	5.6%
2010	4.8%
2011	-3.2%

The sample variance of the portfolio is closest to:

- A. 0.23%.
- B. 0.28%.
- C. 0.36%.

120. Which of the following types of institutions is *most likely* to have a long investment time horizon and a higher level of risk tolerance?

- A. An endowment
- B. An insurance company
- C. A bank

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