Question #1 of 42

Question ID: 1104259

According to the Central Limit Theorem:

A) the distribution of sample means will be approximately normally distributed only if the population is normally distributed and continuous.

B) inferences about the population mean can be made from the sample mean, as long as the sample size is sufficiently large. ✔

C) the sample mean will have a standard deviation equal to the population standard deviation divided by the sample size.

Explanation

According to the Central Limit Theorem, if the sample size is large, the sample mean will be distributed normally regardless of the population's distribution, specific inferences can be about the population mean, and the sample mean will have a standard deviation equal to the population standard deviation divided by the square root of the sample size (also known as the standard error).

For Further Reference:

(Study Session 3, Module 11.1, LOS 11.e)

SchweserNotes, Book 1 page 252

CFA® Program Curriculum, Volume 1, page 586

Question #2 of 42

Question ID: 1104262

George Hutchins, CFA, would like to perform a paired comparisons test on returns for the stocks of two real estate investment trusts. The test statistic that Hutchins should select for the paired comparisons test is the:

A) *t*-statistic. ✔

B) *F*-statistic.

C) Chi-square statistic.

Explanation

The paired comparisons test is performed using a *t*-statistic with n–1 degrees of freedom.

For Further Reference:

(Study Session 3, Module 12.3, LOS 12.i)

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SchweserNotes, Book 1 page 292

CFA® Program Curriculum, Volume 1, page 642

Question #3 of 42

Question ID: 1104253

Hugh Benson, CFA, purchases a $100,000 Treasury bill that matures in 90 days for $97,750. If Benson holds the bill until maturity, he will earn a holding period yield (HPY) of 2.3%. To state the return on a different basis, Benson can:

A) multiply the HPY by 365/90 to determine the money market yield.

B) compound the HPY for four periods to calculate the effective annual yield.

C) convert the HPY to a semiannual effective yield and multiply by 2 to calculate the bond equivalent yield. ✓

Explanation

Calculating the BEY is a two-step process. First, the HPY is converted to a semiannual effective yield. Second, the semiannual effective yield is multiplied by 2 to determine the BEY. The effective annual yield = $(1 + \text{HPY})^{365/90}$ and the money market yield = HPY × (360/90).

For Further Reference:

(Study Session 2, Module 7.2, LOS 7.f)

SchweserNotes, Book 1 page 118

CFA® Program Curriculum, Volume 1, page 374

Question #4 of 42

Question ID: 1104257

After repeatedly sampling the 1-year returns on the common stock of Bernouli Inc., a semiconductor manufacturer, an analyst notices that the returns conform to a normal probability distribution. Which of the following statements *correctly* describes the returns on Bernouli's common stock?

A) The mean value is greater than the median.

B) Large deviations from the mean are less likely than small deviations. ✓

C) The distributions can be completely described by the residual value and the standard deviation.

Explanation

In a normal distribution, large deviations from the mean (in the "tails" of the distribution) are less likely than small deviations from the mean. A normal probability distribution is completely identified by its mean and standard deviation and has a mean equal to its mode and median.

For Further Reference:

(Study Session 3, Module 10.2, LOS 10.i)

SchweserNotes, Book 1 page 223

CFA® Program Curriculum, Volume 1, page 541

Question #5 of 42

Question ID: 1104254

Returns data for Limbo Company exhibit the following statistics:

Mean	9.5%
Median	14.3%
Excess Kurtosis	–0.97

The returns distribution for Limbo Company is:

A) positively skewed.
B) negatively skewed. ✓
C) not skewed.

Explanation

Since the median is higher than the mean, the distribution is negatively skewed. If the mean were higher than the median the distribution would be positively skewed.

For Further Reference:

(Study Session 2, Module 8.3, LOS 8.j, 8.k, 8.l)

SchweserNotes, Book 1 page 151

CFA® Program Curriculum, Volume 1, page 445

SchweserNotes, Book 1 page 152

CFA® Program Curriculum, Volume 1, page 445

SchweserNotes, Book 1 page 153

CFA® Program Curriculum, Volume 1, page 448

Question #6 of 42

Question ID: 1104263

Which of the following assumptions is *least* consistent with technical analysis?

A) Interaction of supply and demand causes trends in stock prices.
B) Information flow causes the market to reach a new equilibrium quickly. ✓
C) Supply and demand is governed by both rational and irrational factors.

Explanation

Technical analysts believe the flow of information into the market is gradual, causing the market to adjust prices to a new equilibrium over a significant period of time.

For Further Reference:

(Study Session 3, Module 13.1, LOS 13.a)

SchweserNotes, Book 1 page 314

CFA® Program Curriculum, Volume 1, page 676

Question #7 of 42

Question ID: 1104261

Alice Morton, CFA, is reviewing a research paper that reaches a conclusion based on two hypothesis tests with *p*-values of 0.037 and 0.064. Morton should conclude that:

A) both of these tests' null hypotheses can be rejected with 90% confidence. ✓

B) neither of these tests' null hypotheses can be rejected with 95% confidence.

C) only one of these tests' null hypotheses can be rejected with 99% confidence.

Explanation

The *p*-value of a hypothesis test is the smallest significance level at which the null hypothesis can be rejected. Because both tests' *p*-values are less than 10%, both null hypotheses can be rejected at the 10% significance level (or at the 90% confidence level). One of the tests has a *p*-value greater than 5%, so the null hypothesis being tested cannot be rejected at the 5% significance (95% confidence) level. Neither test has a *p*-value less than 1%, so neither null hypothesis can be rejected at the 1% significance (99% confidence) level.

For Further Reference:

(Study Session 3, Module 12.2, LOS 12.f)

SchweserNotes, Book 1 page 284

CFA® Program Curriculum, Volume 1, page 629

Question #8 of 42

Question ID: 1104260

Analyst Shelly King is using a returns and earnings database to examine the past performance of stocks. King sorts stocks from high to low P/E ratio by dividing the beginning of the year stock price by the reported year-end earnings per share recorded in the database for the prior year. King then creates portfolios of high P/E stocks and low P/E stocks and compares their performance. King's research design *most likely* suffers from:

A) time period bias.

B) data mining bias.

C) look-ahead bias. ✓

Explanation

King has designed a trading strategy based on P/E ratios. All the necessary accounting information must be available in order to implement the strategy. At the beginning of a new year, the earnings from the recently ended fiscal year will not be released for several weeks and perhaps months into the new year. By assuming the fiscal year-end earnings are available at the beginning of the new fiscal year, King is introducing a look-ahead bias into her research design. Time period bias refers to a research design in which results are time-specific and cannot be generalized reliably outside the sample period. Data mining bias refers to the likelihood that in repeated testing of data for various strategies or patterns, eventually a pattern will emerge by chance.

For Further Reference:

(Study Session 3, Module 11.2, LOS 11.k)

SchweserNotes, Book 1 page 262

CFA® Program Curriculum, Volume 1, page 599

Question #9 of 42

Question ID: 1104255

The probability that the economy will enter a recession after the Federal Reserve increases the federal funds target rate is 60%, and the probability that the economy will enter a recession if the Federal Reserve does not increase the federal funds target rate is 10%. The unconditional probability that the economy will fall into recession is determined using the:

A) total probability rule. ✓
B) addition rule for probabilities.
C) multiplication rule for probabilities.

Explanation

The unconditional probability that the economy will enter a recession is determined using the total probability rule, which is expressed by the following equation:

P(R) = P(recession and interest rates increase) or P(recession and no interest rate increase)

$P(R) = P(R \text{ and } I) + P(R \text{ and } I^c)$

$P(R) = P(R|I)P(I) + P(R|I^c)P(I^c)$

For Further Reference:

(Study Session 2, Module 9.1, LOS 9.e)

SchweserNotes, Book 1 page 172

CFA® Program Curriculum, Volume 1, page 477

Question #10 of 42

Question ID: 1104256

\ Cheryl Smith, CFA, is comparing dividend changes for energy and non-energy companies. Smith determines that 15% of the stock market universe consists of energy companies. Smith also determines that the probability that an energy company will increase its dividend is 90% and the probability that a non-energy company will increase its dividend is 30%. If Smith randomly selects one company from the universe of stocks and notices that the company declared a dividend increase, the probability that the company Smith selected is an energy company is *closest* to:

A) 5%.
B) 15%.
C) 35%. ✓

Explanation

Initially, we are told that the probability of randomly selecting an energy company is 15% ("Smith determines that 15% of the stock market universe consists of energy companies"). This is the prior probability. But Smith gathers new information that she can use to update her prior probability—the randomly selected stock recently declared a dividend increase. Intuitively, we know the updated probability will be much higher than 15% because dividend increases are likely to occur much more often for energy companies (90% of the time) than for non-energy companies (30% of the time). Thus, the correct choice must be 35%.

We can obtain the exact answer using Bayes' formula:

updated probability=P(E|D)=P(E)×P(D|E)P(D),

where:

- P(E) is the prior probability that the selected company is an energy company.
- P(D|E) is the probability of the new information (dividend increase) for a given event (energy company).

- P(D) is the unconditional probability of the new information (dividend increase).

P(E) is provided in the question as 15%. P(D|E) also is provided in the question as 90%. P(D) is the probability of a dividend increase, which can occur either if the randomly selected company is an energy company or a non-energy company:

$$P(D) = [P(E) \times P(D|E)] + [P(E^c) \times P(D|E^c)] = [0.15 \times 0.90] + [0.85 \times 0.30] = 0.39.$$

Therefore, updated probability = 0.15 × 0.900.39 = 0.346 = 34.6%

For Further Reference:

(Study Session 2, Module 9.3, LOS 9.n)

SchweserNotes, Book 1 page 191

CFA® Program Curriculum, Volume 1, page 502

Question #11 of 42

Question ID: 1104258

Lee Phillips, CFA, estimates that Biolab Inc. should earn \$2.00 per share in 20X1, with a standard deviation of \$1.00. If Biolab's earnings outcomes are normally distributed, the probability that Biolab earns \$3.00 or more in 20X1 is *closest* to:

A) 16%.
B) 32%.
C) 34%.

Explanation

Phillips is interested in the probability of observing a result that is one standard deviation above the expected value for EPS. Approximately 68% of observations fall within plus or minus one standard deviation of the mean. Therefore, 1 − 0.68 = 0.32 or 32% remains in the tails. Since we are interested in the upper tail, we can say that there is 0.32 / 2 = 0.16 or 16% probability of observing an EPS greater than 3.

For Further Reference:

(Study Session 3, Module 10.2, LOS 10.l)

SchweserNotes, Book 1 page 226

CFA® Program Curriculum, Volume 1, page 542

Question #12 of 42

Question ID: 1104252

Jack Long, CFA, is evaluating the retirement account of John Smith. Smith currently has \$500,000 and will retire in 12 years. Smith plans to contribute \$12,700 per year. If Smith needs \$2 million at retirement, the return required is *closest* to:

A) 10%.
B) 11%.
C) 12%.

Explanation

PV = 500,000; N = 12; PMT = 12,700 ; FV = –2,000,000; CPT → I/Y = 11%.

For Further Reference:

(Study Session 2, Module 6.3, LOS 6.e, 6.f)

SchweserNotes, Book 1 page 70

CFA® Program Curriculum, Volume 1, page 306

SchweserNotes, Book 1 page 84

CFA® Program Curriculum, Volume 1, page 307

Question #13 of 42

Question ID: 1111548

In the short run, a perfectly competitive firm's supply curve is:

A) upward sloping and its demand curve is perfectly elastic. ✓

B) upward sloping and its demand curve is downward sloping.

C) perfectly inelastic and its demand curve is perfectly elastic.

Explanation

In the short run, a perfectly competitive firm's supply curve is upward sloping, because if the price increases, firms will increase their quantity supplied. The demand curve for a perfectly competitive firm is horizontal. Each firm in a competitive market is a price taker and has no influence on the price of the product.

For Further Reference:

(Study Session 4, Module 15.1, LOS 15.c)

SchweserNotes, Book 2 page 40

CFA® Program Curriculum, Volume 2, page 68

Question #14 of 42

Question ID: 1104264

A firm under perfect competition finds that the market price of its product is below the firm's average total cost but above its average variable cost. If these conditions persist, the firm should:

A) shut down in the short run and go out of business in the long run.

B) shut down in the short run but continue operating in the long run.

C) continue operating in the short run but go out of business in the long run. ✓

Explanation

Because the market price still allows the firm to recover all of its variable costs (P > AVC) and some of its fixed costs, it should continue operating in the short run and experience smaller losses compared to shutting down immediately. However, if the price is expected to remain below ATC, the firm should go out of business in the long run.

For Further Reference:

(Study Session 4, Module 14.2, LOS 14.e)

SchweserNotes, Book 2 page 11

CFA® Program Curriculum, Volume 2, page 28

Question #15 of 42

Question ID: 1104271

Functions of a central bank *most likely* include:

A) collecting tax payments.
B) balancing the national budget.
C) controlling money supply growth. ✓

Explanation

Central banks control the growth of a country's money supply through their monetary policy actions. Many central banks also regulate their countries' banking systems and issue their countries' currencies. Fiscal policy (taxation and government spending) is generally the responsibility of a country's executive and legislative officials.

For Further Reference:

(Study Session 5, Module 18.1, LOS 18.a, 18.f)

SchweserNotes, Book 2 page 105

CFA® Program Curriculum, Volume 2, page 261

SchweserNotes, Book 2 page 110

CFA® Program Curriculum, Volume 2, page 275

Question #16 of 42

Question ID: 1104272

Tax policy is said to exhibit efficiency if it:

A) is simple to implement and enforce.
B) causes minimal interference with market forces. ✓
C) generates just enough revenues to fund government spending.

Explanation

Tax policy is said to exhibit efficiency if it minimizes its interference with market forces and work incentives.

For Further Reference:

(Study Session 5, Module 18.3, LOS 18.p)

SchweserNotes, Book 2 page 120

CFA® Program Curriculum, Volume 2, page 308

Question #17 of 42

Question ID: 1104275

Which approach to analysis of trade deficits indicates that in the absence of excess capacity in the economy, currency devaluation provides only a temporary improvement in a country's trade deficit, and that long-term improvement requires either a smaller fiscal deficit or a larger excess of domestic savings over domestic investment?

A) Elasticities approach.

B) Absorption approach. ✓

C) Real wealth approach.

Explanation

The absorption approach to analyzing how to improve a trade deficit suggests that in the absence of excess capacity in the economy, currency devaluation provides only a temporary improvement in a country's trade deficit that will reverse after the decrease in real domestic wealth from the currency depreciation is restored. It also concludes that a long-term improvement in the trade deficit requires either an improvement in the fiscal deficit or an increase in the excess of domestic savings over domestic investment.

For Further Reference:

(Study Session 5, Module 20.3, LOS 20.j)

SchweserNotes, Book 2 page 165

CFA® Program Curriculum, Volume 2, page 441

Question #18 of 42

Question ID: 1104267

In measures of national economic output, realized capital gains on assets purchased in an earlier period are a component of:

A) gross domestic product, but not gross national product.

B) gross national product, but not gross domestic product.

C) neither gross domestic product nor gross national product. ✓

Explanation

Gross domestic product (GDP) and gross national product (GNP) measure the value of final goods and services produced during the period. Gains from reselling assets purchased in an earlier period do not reflect current production and are not counted in GDP or GNP. The difference between GDP and GNP is that GDP measures output produced by factors of production located within the country, while GNP measures output produced by factors supplied by the country's citizens.

For Further Reference:

(Study Session 4, Module 16.1, LOS 16.d, Module 19.1, LOS 19.a)

SchweserNotes, Book 2 page 55

CFA® Program Curriculum, Volume 2, page 131

SchweserNotes, Book 2 page 137

CFA® Program Curriculum, Volume 2, page 334

Question #19 of 42

Question ID: 1104269

Rusty Brown worked at a food processing plant. In a move to reduce costs, the plant automated the production line where Brown worked. Brown was laid off because he was not adequately trained to work the new equipment. Gilda Gold was the bookkeeper for a coal mine that was closed because it could not meet safety standards. Which type of unemployment is illustrated by each worker?

A) Brown and Gold are both examples of frictional unemployment.

B) Brown is an example of structural unemployment and Gold is an example of cyclical unemployment.

C) Brown is an example of structural unemployment and Gold is an example of frictional unemployment. ✓

Explanation

Unemployment due to workers lacking the necessary skills for a changing job market is called structural unemployment. Gold will likely seek work elsewhere as a bookkeeper.There was no broad economic downturn that would suggest cyclical unemployment. This is an example of frictional unemployment.

For Further Reference:

(Study Session 4, Module 17.2, LOS 17.d)

SchweserNotes, Book 2 page 88

CFA® Program Curriculum, Volume 2, page 219

Question #20 of 42

Question ID: 1104270

An increase in oil prices reduces short-run aggregate supply. Real GDP decreases and the price level increases. The central bank responds by increasing the money supply to increase aggregate demand and restore full employment. Further increases in oil prices require repeated action by the central bank. This is an example of:

A) an inflationary gap.

B) cost-push inflation. ✓

C) demand-pull inflation

Explanation

Cost-push inflation is initiated by an increase in the price of a key productive input, which reduces short-run aggregate supply, decreasing real GDP to below its full-employment level (a recessionary gap), and increasing the price level. If the central bank responds by expanding the money supply, aggregate demand will increase, moving real GDP toward its full-employment level but increasing the price level further. If additional increases in input prices reduce SRAS and cause the central bank to further expand the money supply to restore full employment, cost-push inflation results.

For Further Reference:

(Study Session 4, Module 17.2, LOS 17.h)

SchweserNotes, Book 2 page 94

CFA® Program Curriculum, Volume 2, page 231

Question #21 of 42

Question ID: 1104266

Assume a cartel is organized among the producers of a commodity and begins practicing collusion. The most likely effects on price and output are that:

A) both will increase.

B) price will increase and output will decrease.

C) price will decrease and output will increase.

Explanation

Collusion is an agreement among firms to avoid various competitive practices. The cartel practicing collusion will be similar to a monopoly, causing prices to increase and output to decrease compared to a competitive market.

For Further Reference:

(Study Session 4, Module 15.3, LOS 15.d)

SchweserNotes, Book 2 page 22

CFA® Program Curriculum, Volume 2, page 68

Question #22 of 42

Question ID: 1104268

Long-run aggregate supply is *most likely* to increase as a result of a(n):

A) increase in expected inflation.

B) decrease in the real wage rate.

C) increase in aggregate hours worked.

Explanation

Factors that affect long-run aggregate supply (potential real GDP) include the quantity of labor available, the quantity of capital available, and the level of technology. An increase in aggregate hours worked is an increase in the quantity of labor, which increases long-run aggregate supply. An increase in expected inflation does not affect long-run aggregate supply, but causes aggregate demand to increase as consumers make purchases sooner and businesses increase investment in anticipation of higher profits. A decrease in the real wage rate increases short-run aggregate supply but does not affect long-run aggregate supply.

For Further Reference:

(Study Session 4, Modules 16.2, 16.3, LOS 16.h, 16.m)

SchweserNotes, Book 2 page 62

CFA® Program Curriculum, Volume 2, page 150

SchweserNotes, Book 2 page 71

CFA® Program Curriculum, Volume 2, page 173

Question #23 of 42

Question ID: 1104274

Assume the exchange rate between the Bucas (BCS) and the Leider (LDR) is 1.70 BCS/LDR, and the exchange rate between the Bucas and the Passoa (PAS) is 3.2 BCS/PAS. The PAS/LDR exchange rate is *closest* to:

A) 0.5313 PAS/LDR.

B) 1.8824 PAS/LDR.

C) 5.4400 PAS/LDR.

Explanation

The PAS/LDR cross rate is (1.70 BCS/LDR) / (3.2 BCS/PAS) = 0.5313 PAS/LDR.

For Further Reference:

(Study Session 5, Module 20.1, LOS 20.d)

SchweserNotes, Book 2 page 159

CFA® Program Curriculum, Volume 2, page 419

Question #24 of 42

Question ID: 1104273

Promoting stability in exchange rates is among the goals of the:

A) World Bank.

B) World Trade Organization.

C) International Monetary Fund. ✓

Explanation

Promoting exchange rate stability is one of the stated goals of the IMF.

For Further Reference:

(Study Session 5, Module 19.2, LOS 19.j)

SchweserNotes, Book 2 page 148

CFA® Program Curriculum, Volume 2, page 379

Question #25 of 42

Question ID: 1104290

Harter Corporation issued $95 million of 10-year 8% coupon bonds in 20X5. In 20X5, the market interest rate was 6%. The current market interest rate is 9%. Harter has generated unexpectedly strong profits over the last several years. Given a high cash balance, the company is considering repurchasing the entire bond issue. If Harter repurchases the bonds, what is the immediate effect in Harter's income statement?

A) A loss is recognized.

B) A gain is recognized. ✓

C) No gain or loss is recognized.

Explanation

The bonds were issued at a premium in 20X5 because the 8% coupon rate exceeded the 6% market interest rate. Since the current market interest rate of 9% is above the coupon rate, Harter can repurchase the bonds at a price below the carrying value. When the carrying value exceeds the reacquisition price, a gain is recognized in the income statement.

For Further Reference:

(Study Session 8, Module 29.3, LOS 29.c)

SchweserNotes, Book 3 page 279

CFA® Program Curriculum, Volume 3, page 557

Question #26 of 42

Question ID: 1104280

A company's investments in marketable securities include a 3-year tax- exempt bond classified as held-to-maturity and a 5-year Treasury note classified as available-for-sale. On its income statement, the company should report the coupon interest received from:

A) both of these securities. ✓

B) neither of these securities.

C) only one of these securities.

Explanation

Interest and dividends received are reported as income, regardless of the balance sheet classification of marketable securities.

For Further Reference:

(Study Session 7, Module 24.6, LOS 24.e)

SchweserNotes, Book 3 page 82

CFA® Program Curriculum, Volume 3, page 167

Question #27 of 42

Question ID: 1104284

An analyst is *most likely* to be concerned about the predictability of a firm's sales if, compared to its industry competitors, the firm has a significantly higher:

A) standard deviation of sales.

B) coefficient of variation of sales. ✓

C) correlation of sales with economic growth.

Explanation

Coefficient of variation of sales (standard deviation of sales / mean sales) is a measure analysts can use to compare the sales variability of different firms. Standard deviation of sales by itself would be expected to be higher for firms with greater sales revenue. High correlation of sales with economic growth suggests a firm is cyclical and therefore expectations about its sales can be based on business cycle expectations.

For Further Reference:

(Study Session 7, Module 25.5, LOS 25.e)

SchweserNotes, Book 3 page 161

CFA® Program Curriculum, Volume 3, page 319

Question #28 of 42

Question ID: 1104276

Information about any conflicts of interest between management, the board of directors, and shareholders can *most likely* be found in the:

A) proxy statement.

B) footnotes.

C) auditor's report.

Explanation

The proxy statement provides information about management and board member compensation, as well as any conflicts of interest.

For Further Reference:

(Study Session 6, Module 21.2, LOS 21.e, Study Session 10, Module 33.1, LOS 33.f)

SchweserNotes, Book 3 page 4

CFA® Program Curriculum, Volume 3, page 29

Question #29 of 42

Question ID: 1104287

How is the impact of selling a long-lived asset recorded on a firm's income statement?

A) The sale proceeds increase revenue and the carrying value increases cost of goods sold.

B) The difference between the sale proceeds and the carrying value is reported as a gain or loss.

C) The difference between the sale proceeds and the original value is reported as a gain or loss.

Explanation

The difference between the sale proceeds and the carrying value for a long-lived asset is reported on a firm's income statement as a gain or loss. The carrying value is the original value less accumulated depreciation.

For Further Reference:

(Study Session 8, Module 27.3, LOS 27.j)

SchweserNotes, Book 3 page 225

CFA® Program Curriculum, Volume 3, page 451

Question #30 of 42

Question ID: 1104292

Which of the following analyst adjustments to improve comparability among firms' financial statements is *most appropriate*?

A) Subtract goodwill from a firm's assets.

B) Add the change in the LIFO reserve to a firm's cost of goods sold.

C) Add the sum of the disclosed payment obligations on operating leases to a firm's liabilities.

Explanation

Subtracting goodwill from assets can help make the financial statements of a firm that has grown through acquisitions more comparable to those of a firm that has generated internal growth. To adjust cost of goods sold from a LIFO basis to a FIFO basis, an analyst should *subtract* the change in the LIFO reserve for the period. When calculating solvency ratios, an analyst should add the *present value* of a firm's disclosed operating lease obligations to the firm's liabilities and long-lived assets.

For Further Reference:

(Study Session 9, Module 31.2, LOS 31.e)

SchweserNotes, Book 3 page 325

CFA® Program Curriculum, Volume 3, page 697

Question #31 of 42

Question ID: 1104285

A firm that reports under IFRS wrote down its inventory from cost of $240,000 to net realizable value of $210,000. In the next period, cost was unchanged, but net realizable value increased to $250,000. The firm will *most appropriately* report ending inventory for the period as:

A) $210,000.
B) $240,000. ✓
C) $250,000.

Explanation

Under IFRS, inventory can be written up when NRV increases but cannot be carried at an amount greater than cost. In this case, the firm can reverse the previously recognized write-down, but may not write up inventory above its cost of $240,000.

For Further Reference:

(Study Session 7, Module 26.4, LOS 26.g)

SchweserNotes, Book 3 page 190

CFA® Program Curriculum, Volume 3, page 368

Question #32 of 42

Question ID: 1104278

At the beginning of the year, Weatherford Corporation had 2,000,000 shares of common stock outstanding. In addition, Weatherford had 150,000 stock options outstanding to purchase common shares at $10 per share. No stock options were exercised during the year. Assuming the average market price of the stock was $15, how many shares should Weatherford use in computing diluted earnings per share for the year?

A) 2,000,000.
B) 2,050,000. ✓
C) 2,150,000.

Explanation

Diluted EPS is computed assuming conversion of the options using the treasury stock method. Accordingly, an additional 50,000 shares are added to compute diluted EPS: ($15 average market price – $10 exercise price) / $15 average market price × 150,000 options = 50,000 shares. 2,000,000 shares + 50,000 shares = 2,050,000 shares.

For Further Reference:

(Study Session 6, Module 22.5, LOS 22.h)

SchweserNotes, Book 3 page 56

CFA® Program Curriculum, Volume 3, page 131

Question #33 of 42

Question ID: 1104283

At the end of last year, Manhattan Corporation had a quick ratio of 1.2. If Manhattan reduces its accounts payable with a cash payment of $2 million, its quick ratio will:

A) be unchanged.

B) increase. ✓

C) decrease.

Explanation

Since the quick ratio is greater than one, the percentage decrease in the denominator (current liabilities) is greater than the percentage decrease in the numerator (cash + accounts receivable + marketable securities). The denominator will decrease relatively more than the numerator. As a result, the quick ratio will increase.

For Further Reference:

(Study Session 7, Module 25.2, LOS 25.b)

SchweserNotes, Book 3 page 143

CFA® Program Curriculum, Volume 3, page 291

Question #34 of 42

Question ID: 1104281

Which of the following *most accurately* describes cash flow classification under U.S. GAAP and IFRS?

A) Dividends paid are a financing activity under U.S. GAAP and dividends received may be shown as an operating or investing activity under IFRS. ✓

B) Dividends received may be shown as an operating or investing activity under U.S. GAAP and dividends paid is a financing activity under IFRS.

C) Interest expense is a financing activity under U.S. GAAP and interest received may be shown as an operating or investing activity under IFRS.

Explanation

Interest received, dividends received, and interest paid are operating cash flows under U.S. GAAP, and dividends paid are financing cash flows. Interest received and dividends received may be shown as operating or investing cash flows under IFRS. Interest paid and dividends paid may be shown as operating or financing cash flows under IFRS.

For Further Reference:

(Study Session 7, Module 24.1, LOS 24.c)

SchweserNotes, Book 3 page 105

CFA® Program Curriculum, Volume 3, page 221

Question #35 of 42

Question ID: 1104279

U.S. GAAP requires unrealized gains and losses on available-for-sale securities to be reported:

A) in non-operating income.

B) in a separate section following net income.

C) as other comprehensive income on the statement of changes in owners' equity. ✓

Explanation

Unrealized gains and losses on securities classified as available-for-sale are recorded as increases (gains) or decreases (losses) in other comprehensive income. Unrealized gains and losses on actively traded securities would be reported in the income statement.

For Further Reference:

(Study Session 6, Module 22.6, LOS 22.m)

SchweserNotes, Book 3 page 67

CFA® Program Curriculum, Volume 3, page 145

Question #36 of 42

Question ID: 1104282

An accountant with Umble Company is preparing the statement of cash flows. Cash flow from operations is $210 and cash on the balance sheet increased by $340. Transactions during the period include:

Capital expenditures	$100
Investment in joint venture	40
Acquisitions	80
Dividends from affiliates	25

Umble's cash flow from financing (CFF) under U.S. GAAP is:

A) –$220.

B) +$195.

C) +$350. ✓

Explanation

CFI includes capital expenditures, the investment in a joint venture, and acquisitions: –100 − 40 − 80 = –220. The dividend from affiliates is included in operating cash flow. CFF is equal to total cash flow minus CFO minus CFI: 340 − 210 − (–220) = 350.

For Further Reference:

(Study Session 7, Module 24.1, LOS 24.a)

SchweserNotes, Book 3 page 103

CFA® Program Curriculum, Volume 3, page 219

Question #37 of 42

Question ID: 1104288

A financial analyst should treat deferred tax liabilities (DTLs) as equity if the DTLs are:

A) due to permanent differences.
B) expected to increase each period.
C) expected to decrease each period.

Explanation

If a firm's deferred tax liabilities are expected to increase each period, they are not expected to reverse and therefore the deferred taxes are not expected to be paid in the foreseeable future. For analysis, the deferred tax liability can be removed and the decrease in liabilities will increase equity. Permanent differences do not create deferred tax items.

For Further Reference:

(Study Session 8, Module 28.2, LOS 28.b)

SchweserNotes, Book 3 page 246

CFA® Program Curriculum, Volume 3, page 510

Question #38 of 42

Question ID: 1104277

The major benefit of financial reporting standards is that they:

A) prevent management from manipulating financial results.
B) ensure that financial reports are usable by a wide range of audiences.
C) enable direct comparisons between companies by requiring them to use standard formats and methods.

Explanation

The importance of reporting standards is that they ensure that financial reports are usable by a wide range of audiences, including analysts. Reporting standards limit the range of presentation formats and accounting methods but do not require all firms to use the same format or methods. Reporting standards do not eliminate management discretion in choosing methods and making estimates, so they do not fully prevent manipulation of financial results.

For Further Reference:

(Study Session 6, Module 22.1, LOS 22.a)

SchweserNotes, Book 3 page 25

CFA® Program Curriculum, Volume 3, page 44

Question #39 of 42

Question ID: 1104286

Which of the following choices about accounting for property, plant, and equipment are *most likely* to reflect a conservative bias?

A) Accelerated depreciation, longer useful lives, and lower salvage values.
B) Straight-line depreciation, longer useful lives, and higher salvage values.

C) Accelerated depreciation, shorter useful lives, and lower salvage values.

Explanation

Conservative accounting recognizes lower earnings in the current period and higher earnings in later periods. With respect to property, plant, and equipment, management with a conservative accounting bias would recognize the most depreciation expense (and thus the lowest earnings) in the current period by choosing an accelerated depreciation method and estimating shorter useful lives and lower salvage values.

For Further Reference:

(Study Session 8, Module 27.2, LOS 27.e, Study Session 9, Module 31.1, 31.c)

SchweserNotes, Book 3 page 218

CFA® Program Curriculum, Volume 3, page 435

SchweserNotes, Book 3 page 307

CFA® Program Curriculum, Volume 3, page 620

Question #40 of 42

Question ID: 1104293

Other things equal, what impact will increasing days sales in payables have on operating cash flow?

A) No impact.
B) Lower operating cash flow.
C) Higher operating cash flow.

Explanation

Stretching accounts payable (increasing days sales in payables) will increase operating cash flow.

For Further Reference:

(Study Session 9, Modules 31.2, 32.3, LOS 31.h, 32.i)

SchweserNotes, Book 3 page 311

CFA® Program Curriculum, Volume 3, page 638

SchweserNotes, Book 3 page 315

CFA® Program Curriculum, Volume 3, page 655

Question #41 of 42

Question ID: 1104289

Manitou Plastics, Inc., has been recording large deferred tax assets after incurring operating losses in the previous three years. At the end of the most recent year, Manitou reported $14 million in deferred tax assets but only $3 million in deferred tax liabilities. Manitou has also reported a valuation allowance related to deferred taxes in the amount of $7.5 million. What is the *most likely* cause of Manitou's reported valuation allowance?

A) Accounting earnings have been manipulated.
B) Future profitability is in doubt.

C) Interest rates have increased.

Explanation

Valuation allowances occur when the probability of utilizing deferred tax assets is in doubt. Deferred tax assets must be reduced by a valuation allowance to reflect the probability that they will never be used.

For Further Reference:

(Study Session 8, Module 28.5, LOS 28.g)

SchweserNotes, Book 3 page 256

CFA® Program Curriculum, Volume 3, page 525

Question #42 of 42

Question ID: 1104291

Service costs for a defined benefit pension plan are recognized on the income statement under:

A) IFRS, but not U.S. GAAP.

B) Both IFRS and U.S. GAAP. ✓

C) Neither IFRS nor U.S. GAAP.

Explanation

Service costs, which are the additional benefits that employees have earned during the period, are recognized as an expense on the current period income statement under both IFRS and U.S. GAAP.

For Further Reference:

(Study Session 8, Module 29.6, LOS 29.j)

SchweserNotes, Book 3 page 291

CFA® Program Curriculum, Volume 3, page 583