

## 2012 Level I Mock Exam: Morning Session

The morning session of the 2012 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.

Questions	Topic	Minutes
1–18	Ethical and Professional Standards	27
19–32	Quantitative Methods	21
33–44	Economics	18
45–68	Financial Statement Analysis	36
69–78	Corporate Finance	15
79–90	Equity Investments	18
91–96	Derivative Investments	9
97–108	Fixed Income Investments	18
109–114	Alternative Investments	9
115–120	Portfolio Management	9
	<b>Total:</b>	<b>180</b>

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**Questions 1 through 18 relate to Ethical and Professional Standards**

1. Which of the following *least likely* reflects the two primary principles of the CFA Institute Rules of Procedure for Proceedings Related to Professional Conduct?
  - A. Confidentiality of proceedings
  - B. Fair process to the member and candidate
  - C. Public disclosure of disciplinary sanctions
2. 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 GIPS criteria?
  - A. Yes
  - B. No, because of non-similar investment strategies
  - C. No, because non-discretionary accounts are not included
3. Adira Badawi, CFA, who owns a research and consulting company, is an independent board member of a leading cement manufacturer in a small local market. Because of Badawi's expertise in the cement industry, a foreign cement manufacturer looking to enter the local market has hired him to undertake a feasibility study. Under what circumstances can Badawi *most likely* undertake the assignment without violating the CFA Institute Code of Ethics and Standards of Professional Conduct? If he:
  - A. makes full disclosure to both companies.
  - B. receives written permission from the local company.
  - C. signs confidentiality agreements with both companies.
4. Noor Mawar, CFA, manages a trust fund with the beneficiary being an orphaned 18-year-old student. The investment policy dictates that trust assets are expected to provide the student with a stable low risk source of income until she reaches the age of 30 years. Based on information from an internet blog, the student asks Mawar to invest in a new business venture she expects will provide high returns over the next 5 years. Mawar ignores the request, instead securing conservative investments to provide sufficient income. Did Mawar *most likely* violate the CFA Institute Code of Ethics and Standards of Professional Conduct?
  - A. Yes
  - B. No, because the client's objectives were met
  - C. No, because the investment time frame does not match the investment horizon

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5. Vishal Chandarana, an unemployed research analyst, recently registered for the CFA Level I exam. After two months of intense interviewing, he accepts a job with a stock brokerage company in a different region of the country. Chandarana posts on a social media blog how being a CFA candidate really helped him get a job. He also notes how relieved he was when his new employer didn't ask him about being fired from his former employer. Which CFA Institute Code of Ethics or Standards of Professional Conduct did Chandarana *least likely* violate?
- A. Misconduct
  - B. Loyalty to Employers
  - C. Reference to the CFA Program
6. Kam Bergeron, CFA, is an equity portfolio manager who often takes time off in the afternoon to play golf with important clients. Today, Bergeron is on the golf course when his game is interrupted by a phone call from his office. The call is from Bergeron's assistant, who notifies him of a steep and accelerating market decline. Bergeron, eager to get back to his golf game, tells his assistant to raise cash by selling 15% of all clients' holdings. Bergeron instructs his assistant to first sell the most liquid stocks in each client's portfolio and then do the same for his personal account. Bergeron is *least likely* to be in violation of which of the CFA Institute Standards of Professional Conduct?
- A. Suitability
  - B. Priority of transactions
  - C. Diligence and reasonable basis
7. Ileana Inkster, CFA, was recently offered a senior management position within the trust department at a regional bank. The department is new, but the bank has plans to expand it significantly over the next few months. Inkster has been told she will be expected to help grow the client base of the trust department. She is informed the trust department plans to conduct educational seminars and pursue the attendees as new clients. Inkster notices recent seminar advertisements prepared by the bank's marketing department do not mention investment products will be for sale at the seminar. The ads indicate attendees can "learn how to immediately add \$100,000 to their net worth." What should Inkster *most likely* do to avoid violating any CFA Institute Standards of Professional Conduct?
- A. Decline to accept the new position
  - B. Accept the position and revise the marketing material
  - C. Accept the position and inform senior management of inadequate compliance procedures

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8. 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. suitability.
  - B. disclosure of conflicts.
  - C. independence and objectivity.
9. Pia Nilsson is a sole proprietor investment advisor. The 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 following actions *most likely* violated the CFA Institute Standards of Professional Conduct?
- A. Nonpayment of CFA Institute membership dues
  - B. Attributing her superior returns to participation in the CFA Program
  - C. Indicating that being a CFA charterholder has enhanced her portfolio management skills
10. Which of the following distinct entities can *least likely* claim compliance with the Global Investment Performance Standards (GIPS)?
- A. A multi-national financial services holding company
  - B. An investment management division of a regional commercial bank
  - C. A locally incorporated subsidiary undertaking investment management services
11. For periods beginning on or after 1 January 2011, the aggregate fair value of total firm assets *most likely* includes all:
- A. fee-paying discretionary accounts.
  - B. fee- and non-fee-paying discretionary accounts.
  - C. fee- and non-fee-paying discretionary and non-discretionary accounts.

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12. In countries where new local laws relating to calculation and presentation of investment performance conflict with GIPS standards, firms who have claimed GIPS compliance should *most likely*:
- A. stop claiming GIPS compliance.
  - B. follow local laws, continue to claim GIPS compliance, and disclose conflicts.
  - C. continue to claim GIPS compliance, disclosing non-compliance with new laws.
13. Firms claiming GIPS compliance must make every reasonable effort to provide a compliant presentation to which of the following?
- A. Existing clients
  - B. Prospective clients
  - C. Both existing and prospective clients
14. James Simone, CFA, the CFO 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 investor briefing and press release information are identical
  - C. No, because the company releases information while the market is closed
15. 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, nor has she discovered any other potential buyers. Given her distressed client's limited time frame, Kozniak purchases the property herself and foregoes 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. Does Kozniak *most likely* violate the CFA Institute Standards of Professional Conduct?
- A. No
  - B. Yes, she did not disclose her potential conflicts of interest to either client.
  - C. Yes, she profited on the real estate to the detriment of her financially stressed client.

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16. Prudence Charmaine, a CFA charterholder, was recently accused in writing of cheating on a professional accounting exam. She denied cheating and successfully defended herself against the allegation. As part of her defense and as evidence of her character, Charmaine stated she is a CFA charterholder and upholds the CFA Institute Code of Ethics and Standards of Professional Conduct. On her next annual Professional Conduct Statement, Charmaine does not report this allegation to CFA Institute. Did Charmaine *most likely* violate the CFA Institute Code of Ethics or Standards of Professional Conduct?
- A. No
  - B. Yes, she improperly used the CFA Institute Code and Standards to defend herself.
  - C. Yes, she did not report the allegation on her annual Professional Conduct Statement.
17. Margie Germaine, CFA, is a risk management consultant who has been asked by a small investment bank to recommend policies to prevent bank employees from front running client orders. These clients generally invest in one or more of the bank's large cap equity unit trusts. To ensure compliance with the CFA Institute Standards of Professional Conduct, Germaine should *least likely* recommend which of the following? Employees should be restricted from trading:
- A. equity related securities.
  - B. without prior permission.
  - C. during established time periods.
18. Johannes Meir, CFA, is a compliance officer for Family Estate Planning, LLC, a private-wealth consulting firm. Many of his colleagues have family members who have started their own retail businesses. Some of Meir's colleagues have been asked by relatives to serve as non-executive directors or advisors to their companies. Meir should *most likely* recommend which of the following policies to ensure compliance with the CFA Institute Standards?
- A. Prohibit employees from becoming directors or advisors
  - B. Require employees to declare all income sources annually
  - C. Require employees to declare all outside business interests

**Questions 19 through 32 relate to Quantitative Methods**

19. If the stated annual interest rate is 20% and the frequency of compounding is monthly, the effective annual rate (EAR) is *closest* to:
- A. 20%.
  - B. 21%.
  - C. 22%.

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20. For a positively skewed unimodal distribution, which of the following measures is *most* accurately described as the largest?

A. Mode  
B. Mean  
C. Median

21. A project offers the following incremental after-tax cash flows:

Year	0	1	2	3	4	5	6
Cash flow (€)	-12,500	2,000	4,000	5,000	2,000	1,000	500

The IRR of the project is *closest* to:

- A. 2.4%.  
B. 4.4%.  
C. 5.5%.
22. Over a four-year period, a portfolio has returns of 10%, -2%, 18%, and -12%. The geometric mean return across the period is *closest* to:
- A. 2.9%.  
B. 3.5%.  
C. 8.1%.
23. The following sample of 10 items is selected from a population. The population variance is unknown.

10	20	-8	2	-9	5	0	-8	2	3
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The standard error of the sample mean is *closest* to:

- A. 3.4.  
B. 3.6.  
C. 10.8.
24. A subset of a population is *best* described as a:
- A. sample.  
B. statistic.  
C. conditional distribution.

25. An analyst collects data relating to five commonly used measures of use of debt (leverage) and interest coverage for a randomly chosen sample of 300 firms. The data comes from those firms' fiscal year 2011 annual reports. This data is *best* characterized as:
- A. time-series data.
  - B. longitudinal data.
  - C. cross-sectional data.
26. A financial contract offers to pay €1,200 per month for five years with the first payment made today. Assuming an annual discount rate of 6.5%, compounded monthly, the present value of the contract is *closest* to:
- A. €61,330.
  - B. €61,663.
  - C. €63,731.
27. A two-tailed *t*-test of the null hypothesis that the population mean differs from zero has a *p*-value of 0.0275. Using a significance level of 5%, the *most* appropriate conclusion is:
- A. reject the null hypothesis.
  - B. accept the null hypothesis.
  - C. the chosen significance level is too high.
28. An analyst collects the following data related to paired observations for Sample A and Sample B. Assume that both samples are drawn from normally distributed populations and that the population variances are not known.

Paired Observation	Sample A Value	Sample B Value
1	25	18
2	12	9
3	-5	-8
4	6	3
5	-8	1

The *t*-statistic to test the hypothesis that the mean difference is equal to zero is *closest* to:

- A. 0.23.
- B. 0.27.
- C. 0.52.

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29. An investor deposits £2,000 into an account that pays continuously compounded interest of 6% (nominal annual rate). The value of the account at the end of four years is *closest* to:
- A. £2,525.
  - B. £2,542.
  - C. £2,854.
30. A graphic depiction of a continuous distribution that shows the left tail to be longer than the right tail is *best* described as having:
- A. leptokurtosis.
  - B. positive skewness.
  - C. negative skewness.
31. When an analyst is unsure of the underlying population distribution, which of the following is *least* likely to increase the reliability of parameter estimates?
- A. Increase in the sample size
  - B. Use of point estimates rather than confidence intervals
  - C. Use of the  $t$ -distribution rather than the normal distribution to establish confidence intervals
32. Consider the following 20 items.

-41	-18	-17	-9	-8
-6	-5	3	3	3
5	5	7	7	11
12	20	21	21	61

The median value of the items is:

- A. 3.
- B. 4.
- C. 5.

**Questions 33 through 44 relate to Economics**

33. Demand for a good is *most likely* to be more elastic when:
- A. the good is a necessity.
  - B. a lesser proportion of income is spent on the good.
  - C. the adjustment to a price change takes a longer time.

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34. A local laundry and dry cleaner collects the following data on its workforce productivity. Workers always work in teams of two, and the laundry earns \$3.00 of revenue for each shirt laundered.

Quantity of Labor (L) (Workers)	Total Product (TP) (Shirts Laundered per Hour)
0	0
2	20
4	36
6	50
8	62

The marginal revenue product (\$ per worker) for hiring the fifth and sixth workers is *closest to*:

- A. 14.
  - B. 21.
  - C. 42.
35. First degree price discrimination is *best* described as pricing that allows producers to increase their economic profit while consumer surplus:
- A. increases.
  - B. decreases.
  - C. is eliminated.
36. Which of the following actions on the part of a central bank is *most* consistent with increasing the quantity of money?
- A. Increasing reserve requirements
  - B. Selling securities on the open market
  - C. Purchasing securities on the open market
37. If a government increases its spending on domestically produced goods by an amount that is financed by the same increase in taxes, the aggregate demand will *most likely*:
- A. increase.
  - B. decrease.
  - C. remain unchanged.

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38. In early 2011, 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: U.S. Dollar	

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

- A. 4,565.
  - B. 7,248.
  - C. 7,761.
39. In a simple economy with no foreign sector, the following equations apply:

Consumption function	$C = 2,500 + 0.80 \times (Y - T)$
Investment function	$I = 500 + 0.30 \times Y - 25 \times r$
Government spending	$G = 1,000$
Tax function	$T = -250 + 0.30 \times Y$
Y: Aggregate income    r: Real interest rate	

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

- A. 1,000.
  - B. 1,163.
  - C. 7,143.
40. Which of the following measures of profit is *most likely* necessary for a firm to stay in business in the long run?
- A. Normal
  - B. Economic
  - C. Accounting

41. A small country has a comparative advantage in the production of pencils. The government establishes an export subsidy for pencils to promote economic growth. Which of the following will be the *most likely* result of this policy?
- A. As new domestic producers enter the pencils market, supply will increase and domestic prices will decline.
  - B. The increase in the domestic producer surplus will exceed the sum of the subsidy and the decrease in the domestic consumer surplus.
  - C. Although domestic producers will receive a net benefit, the policy will give rise to inefficiencies that cause a deadweight loss to the national welfare.
42. Assuming its trading partner does not retaliate, which of the following conditions *must* hold in order for a large country to increase its national welfare by imposing a tariff?
- A. It must have a comparative advantage in the production of the imported good.
  - B. The deadweight loss must be smaller than the benefit of its improving terms of trade.
  - C. It must auction the import licenses for a fee to offset the decline in the consumer surplus.
43. A country having a current account deficit *most likely* will still be able to consume more output than it produces by:
- A. increasing its net foreign liabilities.
  - B. restricting foreign direct investment.
  - C. adjusting interest rates to stimulate higher domestic savings.
44. In the classification of currency regimes, a currency board system (CBS) *most likely* differs from a fixed-rate parity system in that:
- A. a CBS has a discretionary target level of foreign exchange reserves.
  - B. a CBS can peg to a basket of currencies but a fixed-rate system cannot.
  - C. the monetary authority within a CBS does not act as a traditional lender of last resort.

**Questions 45 through 68 relate to Financial Statement Analysis**

45. Which of the following statements is *most* accurate about the responsibilities of an auditor for a publicly traded firm in the United States? The auditor:
- A. assures the reader that the financial statements are free from error, fraud, or illegal acts.
  - B. must express an opinion about the effectiveness of the company's internal control systems.
  - C. must state that he prepared the financial statements according to generally accepted accounting principles.

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46. In accrual accounting, if an adjusting entry results in the reduction of an asset and the recording of an expense, the originating entry recorded was *most likely* a(n):
- A. prepaid expense.
  - B. accrued expense.
  - C. deferred revenue.
47. At the beginning of the year, a company had total shareholders' equity consisting of ¥200,000 in common share capital and ¥50,000 in retained earnings.

During the year, the following events occurred:

	¥
Net income reported	42,000
Dividends paid	7,000
Unrealized loss on available-for-sale investments	3,000
Repurchase of company stock, to be held as Treasury stock	6,000

The total shareholders' equity at the end of the year is *closest* to:

- A. ¥276,000.
- B. ¥279,000.
- C. ¥282,000.

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48. Selected information from a company's comparative income statements and balance sheets is presented below.

**Selected Income Statement Data  
for the year ended August 31<sup>st</sup>  
(US\$ thousands)**

	<u>2011</u>	<u>2010</u>
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 August 31<sup>st</sup>  
(US\$ thousands)**

	<u>2011</u>	<u>2010</u>
<b>Current Assets</b>		
Cash & 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
<b>Current Liabilities</b>		
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 2011 is *closest* to:

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

49. Selected information for a company and the common size data for its industry are provided below.

	Company (£)	Common Size Industry Data (% of sales)
EBIT	76,000	28.0
Pretax profit	66,400	19.6
Net income	44,500	13.1
Sales	400,000	100.0
Total assets	524,488	140.0
Total equity	296,488	74.0
ROE	15.0%	17.7%

Which of the following is *most likely* a contributor to the company's inferior ROE compared to that of the industry? The company's:

- A. tax burden ratio.
  - B. interest burden ratio.
  - C. financial leverage ratio.
50. Which of the following is *least likely* to be a general feature underlying the preparation of financial statements within the IFRS Conceptual Framework?
- A. Matching
  - B. Materiality
  - C. Accrual basis
51. A company suffered a substantial loss when its production facility was destroyed in an earthquake against which it was not insured. Geological scientists were surprised by the earthquake as there was no evidence that one had ever occurred in that area in the past. Which of the following statements is *most* accurate? The company should report the loss on its income statement:
- A. net of taxes if it reports under U.S. GAAP.
  - B. as an extraordinary item if it reports under IFRS.
  - C. as an unusual item if it reports under U.S. GAAP.

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52. The following information is available about a company:

(all figures in \$ thousands)	2011	2010
Deferred tax assets	200	160
Deferred tax liabilities	(450)	(360)
Net deferred tax liabilities	(250)	(200)
Earnings before taxes	4,000	3,800
Income taxes at the statutory rate	1,200	1,140
Current income tax expense	1,000	900

The company's 2011 income tax expense (in thousands) is *closest* to:

- A. \$1,000.
  - B. \$1,050.
  - C. \$1,250.
53. Which of the following inventory valuation methods *best* matches the actual historical cost of the inventory items to their physical flow?
- A. FIFO
  - B. LIFO
  - C. Specific identification
54. A company has announced that it is going to distribute a group of long-lived assets to its owners in a spin-off. The *most* appropriate way to account for the assets until the distribution occurs is to classify them as:
- A. held for sale with no depreciation taken.
  - B. held for use until disposal with no deprecation taken.
  - C. held for use until disposal with depreciation continuing to be taken.

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55. The following information is available from a company's 2011 financial statements:

**Note 6: Employee costs**

<b>(in thousands)</b>	<b>2011</b>	<b>2010</b>
Wages and salaries	\$21,000	\$18,500
Share-based payment costs	600	425
Defined contribution pension plan	1,525	1,462
Retirement benefit obligations (note 17)	728	620
Other employee costs	<u>3,233</u>	<u>3,080</u>
Total employee costs	\$27,086	\$24,087

**Note 17: Retirement benefit obligations**

Amounts recognized in the income statement for the year

<b>(in thousands)</b>	<b>2011</b>	<b>2010</b>
Current service cost	\$ 692	\$ 588
Interest cost on pension obligation	80	65
Expected return on plan assets	(50)	(45)
Past service costs recognized in the year	<u>6</u>	<u>12</u>
Total income statement charge	\$ 728	\$ 620

The pension expense (in thousands) reported in 2011 is *closest* to:

- A. \$1,525.
  - B. \$2,217.
  - C. \$2,253.
56. An analyst is assessing a company's quality of earnings by looking at the cash flow earnings index (operating cash flow divided by net income). Potential problems would *most likely* be indicated if the ratio were consistently:
- A. equal to 1.0.
  - B. less than 1.0.
  - C. greater than 1.0.

57. A retail company that leases the majority of its space has:

- total assets of \$4,500 million,
- total long-term debt of \$2,125 million, and
- average interest rate on debt of 12%.

Note 8 to the 2011 financial statements contains the following information about the company's future beginning of year lease commitments:

**Note 8: Operating leases**

Year	Millions
2012	\$ 200
2013	200
2014	200
2015	200
2016	<u>200</u>
Total	\$ 1,000

After adjustment for the off-balance-sheet financing, the debt-to-total-assets ratio for the company is *closest* to:

- A. 55%.
  - B. 57%.
  - C. 65%.
58. The financial statement that would be *most* helpful to an analyst in understanding the changes that have occurred in a company's retained earnings over a year is the statement of:
- A. changes in equity.
  - B. financial position.
  - C. comprehensive income.
59. Under the IASB Conceptual Framework, one of the qualitative characteristics of useful financial information is that different knowledgeable users would agree that the information is a faithful representation of the economic events that it is intended to represent. This characteristic is *best* described as:
- A. verifiability.
  - B. comparability.
  - C. understandability.

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60. Under U.S. GAAP, interest paid is *most likely* included in which of the following cash flow activities?

- A. Operating only
- B. Financing only
- C. Either operating or financing

61. The following information is available:

Income Statement Items	(\$)
Sales	421,000
Cost of goods sold (COGS)	315,000
Balance Sheet Items	
Cash	30,000
Accounts receivable	40,000
Inventories	36,000
Accounts payable	33,000

The company's cash conversion cycle (in days) is *closest* to:

- A. 38.2.
- B. 45.2.
- C. 76.4.

62. An analyst has calculated the following ratios for a company:

Operating Profit Margin	17.5%
Net Profit Margin	11.7%
Total Asset Turnover	0.89 times
Return on Assets	10.4%
Financial Leverage	1.46
Debt to Equity	0.46

The company's return on equity (ROE) is *closest* to:

- A. 4.8%.
- B. 15.2%.
- C. 22.7%.

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63. According to International Financial Reporting Standards, which of the following conditions *should* be satisfied in order to report revenue on the income statement?

- A. Payment has been received.
- B. Costs can be reliably measured.
- C. Goods have been delivered to the customer.

64. A company entered into a three-year construction project with a total contract price of \$10.6 million and an expected total cost of \$8.8 million. The following table provides cash flow information relating to the contract:

All figures in millions	Year 1	Year 2	Year 3
Costs incurred and paid	\$1.2	\$6.0	\$1.6
Amounts billed and payments received	\$2.4	\$5.6	\$2.6

If the company uses the percentage-of-completion method, the amount of revenue recognized (in millions) in Year 2 is *closest* to:

- A. \$3.5.
- B. \$5.6.
- C. \$7.2.

65. A company recently purchased a warehouse property and related equipment (shelving, forklifts, etc.) for €50 million, which were valued by an appraiser as follows: Land €10 million, building €35 million, and equipment €5 million. The company incurred the following additional costs in getting the warehouse ready to use:

- €2.0 million for repairs to the building's roof and windows
- €0.5 million to modify the interior layout to meet their needs (moving walls and doors, inserting and removing partitions, etc.)
- €0.1 million on an orientation and training session for employees to familiarize them with the facility

The cost to be capitalized to the building account (in millions) for accounting purposes is *closest* to:

- A. €37.0.
- B. €37.5.
- C. €38.5.

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66. On 1 January 2009, a company that prepares its financial statements according to IFRS issued bonds with the following features:

- Face value £20,000,000
- Term 5 years
- Coupon rate 6% paid annually on December 31
- Market rate at issue 4%

The company did not elect to carry the bonds at fair value. In December 2011 the market rate on similar bonds had increased to 5% and the company decided to buy back (retire) the bonds after the coupon payment on December 31. As a result, the gain on retirement reported on the 2011 statement of income is *closest* to:

- A. £340,410.
- B. £371,882.
- C. £382,556.

67. Providing information about the performance of a company, its financial position, and changes in financial position that is useful to a wide range of users is *most* accurately described as the role of:

- A. financial reporting.
- B. the auditor's report.
- C. financial statement analysis.

68. Which of the following is *most likely* a reason that a lessor can offer attractive lease terms and lower cost financing to a lessee? Because the:

- A. lessor retains the tax benefits of ownership.
- B. lessor avoids reporting the liability on its balance sheet.
- C. lessee is better able to resell the asset at the end of the lease.

**Questions 69 through 78 relate to Corporate Finance**

69. When computing the cash flows for a capital project, which of the following is *least likely* to be included?

- A. Tax effects
- B. Financing costs
- C. Opportunity costs

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70. A company has an equity beta of 1.4 and is 60% funded with debt. Assuming a tax rate of 35%, the company's asset beta is *closest* to:
- A. 0.71.  
B. 0.98.  
C. 1.01.
71. A company's taxable income is 17.1% of sales. Assuming taxes of 42% and a dividend payout of 50%, the net profit margin is *closest* to:
- A. 5.0%.  
B. 7.2%.  
C. 9.9%.
72. A project has the following annual cash flows:

Year 0	Year 1	Year 2	Year 3	Year 4
-\$75,000	\$21,600	\$23,328	\$37,791	\$40,815

With a discount rate of 8%, the discounted payback period (in years) is *closest* to:

- A. 2.8.  
B. 3.0.  
C. 3.2.
73. Using the company's income statement presented, its degree of operating leverage is *closest* to:

Income Statement	\$ millions
Revenues	9.8
Variable Operating Costs	7.2
Fixed Operating Costs	1.5
Operating Income	1.1
Interest	0.6
Taxable Income	0.5
Tax	0.2
Net Income	0.3

- A. 1.1.  
B. 1.7.  
C. 2.4.

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74. Based on best practices in corporate governance procedures, it is *most* appropriate for a company's compensation committee to:

- A. include a retired executive from the firm.
- B. link compensation with long-term objectives.
- C. include a representative from the firm's external auditor.

75. The following information is available for a company:

- Bonds are priced at par and they have an annual coupon rate of 9.2%
- Preferred stock is priced at \$8.18 and it 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. 11.5%.
- B. 13.4%.
- C. 14.3%.

76. Financial risk is *most likely* affected by:

- A. dividends.
- B. long-term leases.
- C. general and administrative costs.

77. The following information is available for a firm:

Number of shares outstanding	4 million
Tax rate	40%
Cost of debt (pretax)	10%
Current stock price	\$20.00
Net income	\$6 million

A plan to repurchase \$10 million worth of shares using debt will *most likely* cause the earnings per share to:

- A. increase.
- B. decrease.
- C. remain unchanged.

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78. A 30-day \$10,000 U.S. Treasury bill sells for \$9,932.40. The discount-basis yield (%) is *closest* to:
- A. 8.11.
  - B. 8.17.
  - C. 8.28.

**Questions 79 through 90 relate to Equity Investments**

79. A stop-buy order is *most likely* placed when a trader:
- A. thinks that the stock is overvalued.
  - B. wants to limit the loss on a long position.
  - C. wants to limit the loss on a short position.
80. The type of voting in board elections that is most beneficial to shareholders with a small number of shares is *best* described as:
- A. statutory voting.
  - B. voting by proxy.
  - C. cumulative voting.
81. An investor gathered the following data in order to estimate the value of the company's preferred stock:

Par value of preferred stock offered at a 6% dividend rate	\$100
Company's sustainable growth rate	5%
Yield on comparable preferred stock issues	11.5%
Investor's marginal tax rate	30%

The value of the company's preferred stock is *closest* to:

- A. \$52.17.
- B. \$74.53.
- C. \$96.92.

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82. An investor gathers the following data.

Year	Earnings per share (\$)	Dividends per share (\$)	ROE
2011	3.20	1.92	12%
2010	3.60	1.80	17%
2009	2.44	1.71	13%
2008	2.50	1.60	15%

To estimate the stock's justified forward P/E, the investor prefers to use the compounded annual earnings growth and the average of the payout ratios over the relevant period (i.e., 2008–2011). If the investor uses 11.5% as her required rate of return, the stock's justified forward P/E is *closest* to:

- A. 10.  
B. 12.  
C. 21.
83. An investor evaluating a company's common stock for investment has gathered the following data.

Earnings per share (2012)	\$2.50
Dividend payout ratio (2012)	60%
Dividend growth rate expected during Years 2013 and 2014	25%
Dividend growth rate expected after Year 2014	5%
Investors' required rate of return	12%

Using the two-stage dividend discount model, the value per share of this common stock in 2012 is *closest* to:

- A. \$28.57.  
B. \$31.57.  
C. \$38.70.
84. Which of the following is *least likely* to be directly reflected in the returns on a commodity index?
- A. Roll yield  
B. Changes in the spot prices of underlying commodities  
C. Changes in the futures prices of commodities in the index

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85. A trader who has bought a stock at \$30 is concerned about a downside movement in the stock and would like to place an order that guarantees selling it at \$25. Which of the following will *most likely* help the trader achieve her objective? (GTC = Good-till-cancelled)
- A. "GTC, stop 25, market sell" order
  - B. "GTC, stop 25, limit 25 sell" order
  - C. "put option buy" market order with a strike price of 25
86. A trader who buys a stock priced at \$64 on margin with a leverage ratio of 2.5 and a maintenance margin of 30% will *most likely* receive a margin call when the stock price is at or falls just below:
- A. \$36.57.
  - B. \$44.80.
  - C. \$54.86.
87. Compared to its market-value-weighted counterpart, a fundamentally weighted index will *least likely* have a:
- A. value tilt.
  - B. contrarian "effect."
  - C. momentum "effect."
88. A U.S. institutional money manager prefers to invest in depository instruments of non-domestic equity securities that are privately placed in the U.S. and not subject to the foreign ownership and capital flow restrictions. The type of security that is *most appropriate* for this investor is:
- A. global registered shares.
  - B. global depository receipts.
  - C. American depository shares.

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89. An equity analyst follows two industries with the following characteristics.

**Industry 1:**

A few companies with proprietary technologies; products with unique features; high switching costs; and minimal regulatory influences.

**Industry 2:**

A few companies producing relatively similar products; sales varying with disposable income and employment levels; high capital costs and investment in physical plants; rapid shifts in market shares of competing firms; and minimal regulatory influences.

Based on the above information, the analyst will *most* appropriately conclude that compared to the firms in Industry 2, those in Industry 1 would potentially have:

- A. larger economic profits.
  - B. over-capacity problems.
  - C. high bargaining power of customers.
90. The Gordon growth model is *most* appropriate for valuing the common stock of a dividend-paying company that is:
- A. young and just entering the growth phase.
  - B. experiencing a higher than the sustainable growth rate.
  - C. mature and relatively insensitive to the economic fluctuations.

**Questions 91 through 96 relate to Derivative Investments**

91. Which of the following is *least likely* one of main purposes of derivative markets?
- A. Reveal prices and volatility of the underlying assets
  - B. Improve market efficiency by lowering transaction costs
  - C. Enable companies to more easily practice risk management
92. A futures trader takes a long position of 10 contracts. The initial margin requirement is \$10 per contract and the maintenance margin requirement is \$7 per contract. She deposits the required initial margin on the trade date. On Day 3, her margin account balance is \$40. What is the variation margin on Day 4?
- A. \$30
  - B. \$60
  - C. \$70

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93. A portfolio manager enters into an equity swap with a swap dealer. The portfolio manager agrees to pay the return on the Value index and receive the return on the Growth index. The swap's notional principal is \$50 million and the payments will be made semi-annually. The levels of the equity indices are as follows:

Index	Level at Start of Swap	Level 6 Months Later
Value Index	5,460	5,350
Growth Index	1,190	1,200

The net amount due to the portfolio manager after 6 months is *closest to*:

- A. \$587,158.  
B. \$1,007,326.  
C. \$1,427,494.
94. Epsilon Inc., a U.S. based company, must pay ¥1,000,000,000 to its Japanese component supplier in 3 months. Epsilon approaches a dealer and enters into a USD/JPY currency forward contract, containing a stipulation for physical delivery, to manage the foreign exchange risk associated with the payment to its supplier. Which of these *best* describes Epsilon's currency forward contract?
- A. The dealer will deliver yen on expiration.  
B. The amount of USD exchanged for JPY is determined at expiration.  
C. Epsilon may receive or pay JPY, depending on the exchange rate at expiration.
95. The greater of either zero or the present value of the exercise price minus the underlying price is *most likely* the lower bound on the price of a(n):
- A. European put option.  
B. American put option.  
C. American call option.
96. An investor purchases ABC stock at \$71 per share and executes a protective put strategy. The put option used in the strategy has a strike price of \$66, expires in two months, and is purchased for \$1.45. At expiration, the protective put strategy breaks even when the price of ABC is *closest to*:
- A. \$64.55.  
B. \$67.45.  
C. \$72.45.

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**Questions 97 through 108 relate to Fixed Income Investments**

97. The table below provides a history of a fixed income security's coupon rate and the risk free rate over a five-year period.

Year	Risk Free Rate	Coupon Rate
1	3.00%	6.00%
2	3.50%	5.00%
3	4.25%	3.50%
4	3.70%	4.60%
5	3.25%	5.50%

The security is *most likely* a(n):

- A. step-up note.
  - B. inverse floater.
  - C. deferred coupon bond.
98. For a 10-year floating-rate security, if market interest rates change by 1%, the change in the value of the security will *most likely* be:
- A. zero.
  - B. related to the security's coupon reset frequency.
  - C. similar to an otherwise identical fixed-rate security.
99. When a bank creates a collateralized loan obligation (CLO) to divest of commercial loans that it owns, the process is *best* described as a(n):
- A. arbitrage transaction.
  - B. balance sheet transaction.
  - C. capital infusion transaction.
100. Which of the following is *closest* to the value of a 10-year, 6% coupon, \$100 par value bond with semi-annual payments assuming an annual discount rate of 7%?
- A. \$92.89
  - B. \$99.07
  - C. \$107.44

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101. Consider a \$100 par value bond with a 7% coupon paid annually and 5 years to maturity. At a discount rate of 6.5%, the value of the bond today is \$102.08. One day later, the discount rate rises to 7.5%. Assuming the discount rate remains at 7.5% over the remaining life of the bond, what is most likely to occur to the price of the bond between today and maturity?
- A. Increases then decreases
  - B. Decreases then increases
  - C. Decreases then remains unchanged
102. A fixed income security's current price is 101.45. You estimate that the price will rise to 103.28 if interest rates decrease 0.25% and fall to 100.81 if interest rates increase 0.25%. The security's effective duration is closest to:
- A. 1.22.
  - B. 4.87.
  - C. 9.74.
103. An analyst reviews a corporate bond indenture that contains these two covenants:
- 1) The borrower will pay interest semi-annually and principal at maturity.
  - 2) The borrower will not incur additional debt if its debt/capital ratio is more than 50%.
- What types of covenants are these?
- A. Both are affirmative covenants.
  - B. Covenant 1 is negative and Covenant 2 is affirmative.
  - C. Covenant 1 is affirmative and Covenant 2 is negative.
104. An investor sells a bond at the quoted price of \$98.00. In addition he receives accrued interest of \$4.40. The clean price of the bond is:
- A. par value plus accrued interest.
  - B. accrued interest plus agreed upon bond price.
  - C. agreed upon bond price excluding accrued interest.
105. An investor purchases a 5% coupon bond maturing in 15 years for par value. Immediately after purchase, the yield required by the market increases. The investor would then most likely have to sell the bond at:
- A. par.
  - B. a discount.
  - C. a premium.

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106. Given two otherwise identical bonds, when interest rates rise, the price of Bond A declines more than the price of Bond B. Compared to Bond B, Bond A most likely:
- A. is callable.
  - B. has a lower coupon.
  - C. has a shorter maturity.
107. A BBB-rated corporation wishes to issue debt to finance its operations at the lowest cost possible. If it decides to sell a pool of receivables into a special purpose vehicle (SPV), its primary motivation is most likely to:
- A. allow the corporation to retain a first lien on the assets of the SPV.
  - B. segregate the assets into a bankruptcy-remote entity for bondholders.
  - C. receive a guaranty from the SPV to improve the corporation's credit rating.
108. Which of the following is least likely a tool used by the U.S. Federal Reserve Bank to directly influence the level of interest rates?
- A. Verbal persuasion
  - B. Open market operations
  - C. Setting the rate on 30-year bonds

**Questions 109 through 114 relate to Alternative Investments**

109. Which of the following most likely trades in the secondary markets?
- A. Open-end funds
  - B. Closed-end funds
  - C. Unit investment trusts

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110. An analyst is evaluating an investment in an apartment complex based on the following annual data:

Gross potential rental income	\$2,100,000
Estimated vacancy and collection expenses	3%
Operating expenses	\$1,600,000
Depreciation	300,000
Current mortgage rate	5%
Financing percentage	80%
Market capitalization rate	12%
Cost of equity	15%

Based on the income approach, the value of the investment is *closest* to:

- A. \$1,141,667.  
B. \$3,641,667.  
C. \$6,242,857.
111. Which of the following statements regarding biases in hedge fund performance in hedge fund databases is least likely correct?
- A. Only hedge fund managers with good track records enter the database, creating a positive bias.  
B. The correlations between asset class returns are artificially low when underlying assets trade infrequently.  
C. Hedge fund database administrators decide which funds to include in the database to overcome self-selection bias.
112. A project that requires an initial investment of €5 million is expected to pay €22 million at the end of five years if it is successful. The probabilities of failure for the project are provided below:

Year	1	2	3	4	5
Failure Probability	0.25	0.20	0.15	0.15	0.15

Assuming the cost of capital for the project is 16%, the project's expected net present value is *closest* to:

- A. –€3,157,000.  
B. –€1,140,000.  
C. €2,017,000.

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113. When market participants expect the spot price of a commodity to be higher in the future, the commodity market is most likely said to be in:
- A. contango.
  - B. full carry.
  - C. backwardation.
114. Which of the following is least likely a reason for discounting the value of stock in a closely held company?
- A. Illiquidity
  - B. Marketability
  - C. Controlling interest

**Questions 115 through 120 relate to Portfolio Management**

115. 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. A bank
  - B. An endowment
  - C. An insurance company
116. An investor's transactions in a mutual fund and the fund's returns over a four-year period are provided in the table below:

	Year			
	1	2	3	4
New investment at the beginning of the year	\$2,500	\$1,500	\$1,000	\$0
Investment return for the year	-20%	65%	-25%	10%
Withdrawal by investor at the end of the year	\$0	-\$500	-\$500	\$0

Based on these data, the money-weighted return (or internal rate of return) for the investor is closest to:

- A. 2.15%.
- B. 3.96%.
- C. 7.50%.

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117. Selected information about shares of two companies is provided below:

Stock	Standard Deviation	Correlation of Returns <sup>1</sup>	Portfolio Weights
Cable Incorporated	30%	0.65	68%
GPTA Company	20%		32%

<sup>1</sup> Correlation of returns between Cable Incorporated and GPTA Company

The standard deviation of returns of the portfolio formed with these two stocks is *closest to*:

- A. 25.04%.
- B. 26.80%.
- C. 32.85%.

118. Risk that can be attributed to factor(s) that impact a company or industry is best described as:

- A. market risk.
- B. systematic risk.
- C. unsystematic risk.

119. A stock has a correlation of 0.45 with the market and a standard deviation of returns of 12.35%. If the market has a standard deviation of returns of 8.25%, then the beta of the stock is closest to:

- A. 0.30.
- B. 0.67.
- C. 1.50.

120. Which of the following factors is *least likely* to impact an individual's ability to take risk?

- A. Time horizon
- B. Personality type
- C. Expected income

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