2008 Level 1 Sample Exam Volume 2

SS1-Ethics and Professional Standards

6. To comply with the Global Investment Performance Standards, a firm must initially show GIPS-compliant history for a minimum of:

   A. two years, or since inception if the firm has been in existence for less than two years.
   B. three years, or since inception if the firm has been in existence for less than three years.
   C. five years, or since inception if the firm has been in existence for less than five years.
   D. seven years, or since inception if the firm has been in existence for less than seven years.

9. Jiro Sato, CFA, deputy treasurer for May College, manages the Student Scholarship Trust. Sato issued a Request for Proposals (RFP) for domestic equity managers. Pamela Peters, CFA, a good friend of Sato, introduces him to representatives from Capital Investments, who submitted a proposal. Sato selected Capital as a manager based on the firm's excellent performance record. Shortly after the selection, Peters, who had outstanding performance as an equity manager with another firm, accepted a lucrative job with Capital. Have Sato and Peters, respectively, violated any CFA Institute Standards of Professional Conduct?

	Sato	Peters
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

SS2/3-Quantitative Methods

15. An analyst gathered the following information about a portfolio's performance over the past ten years:

Mean annual return	12.8%
Mean excess return	7.4%
Standard deviation of annual returns	15.7%
Portfolio beta	1.2

The coefficient of variation and Sharpe measure, respectively, for the portfolio are closest to:

	Coefficient of variation	Sharpe measure
A.	0.82	0.39
B.	0.82	0.47

C.	1.23	0.39
D.	1.23	0.47

16. An analyst gathered the following information about the performance of four categories of mutual funds over the same time period:

Mutual Fund Category	Standard Deviation	Sharpe Ratio
1	18.9%	0.23
2	15.4%	0.35
3	14.3%	0.29
4	12.8%	0.27

If the returns from all funds were normally distributed, the mutual fund category that minimized the probability of earning less than the risk-free rate of return is *most likely* category:

A. 1.
B. 2.
C. 3.
D. 4.

SS4/5/6-Economics

17. Compared to using a single price in a market characterized by monopolistic competition, using price discrimination when two customer groups have different demand elasticities are ***least likely*** to result in:

A. New productive ventures.
B. An increase in total output.
C. Lower prices for both groups.
D. A reduction in allocative inefficiency.

19. Which of the following statements is most likely to characterize the principal-agent problem between buyers and sellers of services?

A. Agents cannot be completely monitored.
B. Agents cannot exercise their own judgment.
C. Principals can impose their own objectives on agents.
D. Principals can have complete information about agent behavior.

20. The crowding-out model suggests that the stimulus effect of increased government expenditures will be modified by changes in real interest rates and the flow of foreign financial capital, because real interest rates will:

A. Rise band inflows of financial capital from outside the country will increase.
B. Rise and inflows of financial capital from outside the country will decrease.
C. Fall and inflows of financial capital from outside the country will increase.
D. Fall and inflows of financial capital from outside the country will decrease.

21. A company has determined that the quantity of that company's product demanded increases by 10% when price is reduced by 5%. That company's elasticity of demand is best described as:

A. Unitary elastic.
B. Perfectly elastic.
C. Relatively elastic.
D. Perfectly inelastic.

22. For markets with perfectly elastic supply and perfectly inelastic supply, respectively, the introduction of a tax will *most likely* result in:

	Markets with perfectly elastic supply	**Markets with perfectly inelastic supply**
A.	a price increase, and the seller bears the tax.	a price increase, and the buyer bears the tax.
B.	a price increase, and supply remains the same.	No change in price, and the seller bears the tax.
C.	a price increase, and the buyer bears the tax.	no change in price, and the seller bears the tax.
D.	no change in price, and the seller bears the tax.	a price increase, and the buyer bears the tax.

SS7/8/9/10-Financial Statement Analysis

23. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. An analyst suspects that a particular company's financial statements may require adjustment because the company uses throughput agreements. The *most likely* effect of the appropriate adjustments on the company's return on assets (ROA) and debt-to-equity ratio, respectively, would be:

	ROA	**Debt-to-equity ratio**
A.	Increase	Increase
B.	Increase	Decrease
C.	Decrease	Increase
D.	Decrease	Decrease

24. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. Which of the following adjustments to the assumed useful life and assumed salvage value of a company's assets would *most likely* decrease the company's total asset turnover ratio?

	Assumed useful life	Assumed salvage value
A.	Longer	Lower
B.	Longer	Higher
C.	Shorter	Lower
D.	Shorter	Higher

26. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. The Regional Bank of Australia receives interest income on the loans it has outstanding. Durango Manufacturing Inc. also receives interest income on some surplus funds they currently have invested in corporate bonds. For each company, respectively, the interest income they receive would be classified as which type of business activity for financial reporting purposes?

	The Regional Bank of Australia	Durango Manufacturing Inc.
A.	Operating activity	Operating activity
B.	Operating activity	Investing activity
C.	Investing activity	Operating activity
D.	Investing activity	Investing activity

27. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. What is the effect on the accounting equation when Chamonix Inc. declares a cash dividend?

A. Assets decrease and liabilities increase.
B. Assets decrease and owners' equity decreases.
C. Liabilities increase and owners' equity decreases.
D. There is no effect on the accounting equation until the dividend is paid.

28. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. Which of the following trends may signal the beginning of a liquidity crisis for an entity?

A. An increase in trade debt.
B. A shift from operating debt to financing liabilities.
C. An increase in trade credit and decrease in retained earnings.
D. A shift from operating debt to increases in owners' contributed capital.

29. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. Disclosures related to the valuation allowance for changes in the carrying amount of a company's noncurrent investment securities will *most likely* be included in the company's:

A. Balance sheet.
B. Income statement.
C. Statement of cash flows.
D. Statement of stockholders' equity.

30. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. Compared to the completed contract method of revenue recognition, will the percentage-of-completion method *most likely* result in higher:

	Total assets?	Liabilities?
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

31. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. River company paid cash dividends during the year. What is the *most likely* effect of this transaction on the statement of cash flows?

A. A cash outflow in cash flow from operations.
B. A cash outflow in cash flow from investing activities.
C. A cash outflow in cash flow from financing activities.
D. No effect, because dividends are not reported on the statement of cash flows.

32. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. An analyst gathered the following information from a company's financial statements ($ millions):

Year ended 31 December	2003	2004
Sales	320.1	322.8
Net income	26.8	27.2
Cash flow from operations	38.1	15.3

Based only on the information above, during 2004 the company most likely decreased the:

A. Proportion of sales made on a cash basis.
B. Inventory anticipating lower demand for its products in 2005.
C. Proportion of interest-bearing debt relative to trade accounts payable.
D. Investment in long-term assets by selling undeveloped land at a substantial loss.

33. Assume U.S. GAAP (generally accepted accounting principles) applies unless; otherwise noted. A company accrued wages of $2,000 and collected accounts receivable of $10,000. What are the *most likely* effects of these two transactions on the company's current ratio and cash flow from operations, respectively?

	Current ratio	Cash flow from operations
A.	Increase	Increase
B.	Increase	Decrease
C.	Decrease	Increase
D.	Decrease	Decrease

SS11-Corporate Finance

35. Is the post-audit performed as part of the capital budgeting process expected to improve a firm's:

	forecasts?	operations?
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

37. A company is considering the development of land acquired as an investment more than ten years ago. If developed, the property would then be used as an additional warehouse facility by the company. The company originally paid $400,000 for the undeveloped land and the company estimates the cost to develop the land for use as a warehouse to be $250,000. Alternatively, the undeveloped land could be sold today for $600,000. To determine the warehouse facility's net present value, which of the following is the most appropriate treatment of the land's:

	$400,000 original cost?	$600,000 market value?
A.	Sunk cost	Sunk cost
B.	Sunk cost	Opportunity cost
C.	Opportunity cost	Sunk cost
D.	Opportunity cost	Opportunity cost

39. Pietro Cecere has calculated the following ratios for Vienza Company:

Number of days of receivables	48
Number of days of inventory	37
Number of days of payables	28

The operating cycle and cash conversion cycle, respectively, for Vienza Company are closest to:

	Operating cycle	Cash conversion cycle
A.	57 days	57 days
B.	57 days	85 days
C.	85 days	57 days
D.	85 days	85 days

SS13/14-Equity Investments

41. The most appropriate reason for an investor to sell a security short is the investor's belief that, in the near future:

A. Interest rates will decline.
B. The security's price will decline.
C. The earnings growth rate for the security will increase.
D. The required rate of return on the security will decline.

42. An analyst gathered the following information for a U.S. company whose common stock is currently priced at $40 per share:

	2002	2003	2004	2005	2006
Earnings per share ($)	1.16	0.62	1.28	1.60	(1.30)
Book value per share ($)	8.48	8.92	16.04	19.28	16.30
Return on equity	14%	7%	8%	8%	

Because of the severe cyclical contraction that occurred in 2006 for a major segment of the company's operations, the analyst has decided to normalize earnings using the 2002-2005 period. If the analyst also decides to account for changes in the company's size over time, the most appropriate estimate of the company's 2006 price/earnings (P/E) ratio based on normalized earnings is:

A. 22.5.
B. 26.5.
C. 34.3.
D. 59.5.

44. An analyst gathered the following information about a company:

Current earnings per share (E_0) reported	$5.00
Current dividend per share (D_0) paid on the company's common stock	$3.00
Required rate of return on the company's common stock	15.0%
Expected constant growth rate in earnings and dividends	7.0%

The value of a share of the company's stock and the leading price/earnings (P/E) ratio, respectively, are closest to:

	Value of stock	Leading P/E ratio
A.	$37.50	7.5
B.	$37.50	8.0
C.	$40.13	7.5
D.	$40.13	8.0

SS17-Derivative Investments

46. Do options and futures, respectively, most directly reveal the prices or the volatility of their underlying assets?

	Options	Futures
A.	Prices	Prices
B.	Prices	Volatility
C.	Volatility	Prices
D.	Volatility	Volatility

47. A private agreement between two parties to exchange a series of future cash flows, with at least one of the two series of cash flows determined by a later outcome, is best characterized as a(n):

A. swap.
B. futures contract.
C. exchange-traded contingent claim.
D. over-the-counter contingent claim.

SS18-Alternative Investments

49. Do hedge funds typically have a(n):

	focus on relative returns?	option-like fee structure?
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

50. An analyst compared the performance of a hedge fund index with the performance of a major stock index over the past eight years. She noted that the hedge fund index (created from a database) had a higher average return, higher standard deviation, and higher Sharpe ratio than the stock index. All the successful funds that have been in the hedge fund database continued to accept new money over the eight-year period. Are the average return and the standard deviation, respectively, for the hedge fund index most likely overstated or understated?

	Average return for the hedge fund index	Standard deviation for the hedge fund index
A.	Overstated	Overstated
B.	Overstated	Understated
C.	Understated	Overstated
D.	Understated	Understated

SS15/16-Fixed Income Investments

55. Would credit spread most likely widen during an economic:

	Contraction?	Expansion?
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

56. An analyst notes that the yield on a 10-year corporate bond is 6.15% and the yield on a 10-year government bond is 4.20%. The relative yield spread and yield ratio, respectively, for the two bonds are *closest* to:

	Relative yield spread	Yield ratio
A.	31.7%	0.68
B.	31.7%	1.46
C.	46.4%	0.68
D.	46.4%	1.46

57. For a decline in interest ratio, the price of a callable bond, when compared to an otherwise identical option-free bond, will most likely rise by:

A. Less because the price of the embedded option falls.
B. Less because the price of the embedded option rises.
C. More because the price of the embedded options falls.
D. More because the price of the embedded option rises.

SS12-Portfolio Management

60. When a risk-free asset is combined with a portfolio of risky assets, will the:

	Standard deviation of the resulting portfolio be a linear function of the standard deviation of the risky asset portfolio?	Graph of the possible portfolio return and risk combinations display increasing incremental return per unit of incremental risk change?
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes