

2007 December CFA Level 1 – Sample Exam 5 Questions

SS1-Ethics and Professional Standards

Q1. Marylou Akers is a Level II candidate in the CFA Program. She receives an e-mail from a co-worker who offers to sell her ten unpublished Level II exam questions that the co-worker assures her will be on the next exam. Akers does not respond and deletes the e-mail. According to the Standards of Practice Handbook, did Akers violate any CFA Institute Standards of Professional Conduct?

- A. No
- B. Yes, because she failed to report the situation to CFA Institute.
- C. Yes, because she failed to report the situation to her co-worker's supervisor.
- D. Yes because she allowed the co-worker to commit an act that may compromise the integrity or validity of the CFA examination.

Q4. New Coal Corp. (NCC) is a small Wyoming company that claims to have a proprietary formula that converts coal into a clean energy source. NCC hires Gulliver Anali, CFA, to prepare a research report on the company. Anali relies on NCC for information on the formula's effectiveness. Anxious to issue the report, he does not confirm the information with other sources. NCC widely distributes Anali's research report and posts it on the corporate website. NCC's stock price rises from \$5 to \$30 per share in the following twelve months. Senior NCC management takes the opportunity to sell all of their company shares. According to the Standards of Practice Handbook, did Anali violate any CFA Institute Standards of Professional Conduct?

- A. No
- B. Yes, because his report was based on material nonpublic information.
- C. Yes, because he failed to have a reasonable and adequate basis for his research report.
- D. Yes, because he failed to provide a range of earnings estimates based upon formulas effectiveness

Q7. According to the Standards of Practice Handbook, gifts to members from which of the following sources are least likely to create a loss of independence and objectivity?

- A. clients
- B. brokers
- C. corporate issuers.
- D. underwriters of new securities.

Q8. Firms claiming compliance with the GIPS Standards are least likely to be required to:

- A. undertake the verification process
- B. provide a composite list and description to any prospective client on request.
- C. document their policies and procedures used in establishing and maintaining compliance
- D. make every reasonable effort to provide a compliant presentation to all prospective clients.

Q9. Fallon Stowe, CFA, included in her firm's marketing materials several plain-language descriptions of general investment concepts such as standard deviation and duration, which were copied from other sources without reference to the original author. According to the Standards of Practice Handbook, has Stowe violated the Standard relating to misrepresentation?

- A. Yes.
- B. No, because these are well-known concepts
- C. No, because she did not misrepresent the descriptions of these concepts.
- D. No, because she did not personally take credit for the distributed material.

SS2/3-Quantitative Methods

Q10. The scale-free measure of relative dispersion that is useful in making direct comparisons among different asset classes is the:

- A. range.
- B. variation.
- C. standard deviation
- D. coefficient of variation

Q12. Which of the following statements used to describe the Student's t-distribution is least accurate? The Student's t-distribution:

- A. involves two random variables.
- B. is less peaked than the normal distribution
- C. is symmetric around its mean value of zero.
- D. has thinner tails than the normal distribution

Q13. Which of the following decisions by an analyst would most accurately describe a Type II error?

- A. An analyst rejects a true null hypothesis.
- B. An analyst rejects a false null hypothesis.
- C. An analyst does not reject a true null hypothesis.
- D. An analyst does not reject a false null hypothesis.

Q14. For an investment portfolio, the Sharpe ratio is best described as a (n):

- A. relative measure that indicates risk per unit of mean return.
- B. absolute measure that indicates risk per unit of mean return.
- C. relative measure that indicates mean excess return per unit of risk.

D. absolute measure that indicates mean excess return per unit of risk

Q15. An analyst gathered information about three economic variables. He noted that whenever variable A increased by one unit, variable B increased by 0.5 units but variable C decreased by 0.5 units. The correlation between variables A and B and the correlation between variables A and C, respectively, are closest to:

	Correlation between variables A and B	Correlation between variables A and C
A	0.5	-1.0
B	0.5	-0.5
C	1.0	-1.0
D	1.0	-0.5

SS7/8/9/10-Financial Statement Analysis

Q23 Assume U.S. GAAP (Generally Accepted Accounting Principles) applies unless otherwise noted.

A company entered into a three-year construction project with a total contract price of \$5.3 million and expected cost of \$4.4 million. The following table provides cash flow information relating to the contract:

	Year 1	Year 2	Year 3
Costs incurred and paid	\$1,200,000	\$2,700,000	\$500,000
Amounts billed and payments received	\$1,100,000	\$2,800,000	\$1,400,000

What is the cumulative effect of the contract on the cash balance that would have been recorded on the company's balance sheet at the end of Year 2 using the:

	Percentage-of-completion method?	Completed contract method?
A	\$0	\$0
B	\$0	\$100,000
C	\$100,000	\$0
D	\$100,000	\$100,000

Q24. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

A company reported net income of \$130 million and cash flow from operations of \$100 million. The most likely explanation for net income being larger than cash flow from operations is that the company:

- A. realized a loss on long-term investments sold during the year.
- B. purchased new property, plant, and equipment at the beginning of the year
- C. reduced its purchasing activity and inventory levels because of lower demand for its products.
- D. took advantage of substantial trade discounts, lowering the balance in accounts payable during the year.

Q25. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise

noted.

A company issued a \$1,000 face value bond on 1 January. The annual coupon rate on the bond is 10 percent, interest is paid semiannually, and the bond matures in five years. The market rate of interest when the bond was issued was 9 percent on an annual basis. The amount of the initial liability recorded and the interest expense recorded on the first coupon payment date, respectively, were closest to:

	Amount of the initial liability recorded	Interest expense recorded on the first coupon payment date
A	\$1,000	\$47
B	\$1,000	\$50
C	\$1,040	\$47
D	\$1,040	\$50

Q26. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

ARDEN Company purchased a delivery truck for \$75,000 in 2006. ARDEN expected to use the truck for 8 years, and estimated the salvage value to be \$5,000. Additionally, ARDEN estimated driving the truck 400,000 kilometers while they owned it. If in 2007 ARDEN drives the delivery truck 42,000 kilometers, the depreciation expense under straight-line and units-of-production methods, respectively, would be closest to:

	Straight-line method	Units-of-production method
A	\$8,750	\$7,350
B	\$8,750	\$7,875
C	\$9,375	\$7,350
D	\$9,375	\$7,875

Q28. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

If both inventory prices and inventory quantities for a company are increasing, which of the following inventory accounting methods results in the:

	Most informative income statement	Inventory balance sheet amount closest to economic value?
A	LIFO	FIFO
B	LIFO	Weighted-average
C	Weighted-average	FIFO
D	Weighted-average	Weighted-average

Q29. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

When market interest rates increase, will a company that issued fixed-rate debt prior to the increase in rates most likely experience a (n):

	Economic loss?	Change in the amount of debt recorded on the balance sheet?
A	No	No
B	No	Yes
C	Yes	No
D	Yes	Yes

Q30. 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 take-or-pay 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

Q31. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

A company reported deferred tax liabilities of \$500,000 and deferred tax assets of \$350,000. If tax rates change and the company continues to grow, using the liability method of accounting for deferred taxes will most likely result in:

- A. increased equity if tax rates increase
- B. increased equity if tax rates decrease
- C. no change in equity because the deferred tax liability is not likely to reverse.
- D. no change in equity because a change in tax rates does not affect existing deferred tax accounts.

Q32. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

A company reported a large increase in gross profit margin compared to the prior year. The large increase in gross profit margin most likely resulted from a reduction in:

- A. interest expense
- B. the marginal tax rate
- C. the number of units in the LIFO inventory.
- D. solvency risk resulting from the issuance of additional shares of common stock

Q33. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

A lessee company entered into a five-year lease agreement on 1 January 2004. For 2004, which type of lease would most likely have the greatest effect on that company's cash flow from

operations and cash flow from financing activities, respectively?

	Cash flow from operations	Cash flow from financing
A	Capital lease	Capital lease
B	Capital lease	Operating lease
C	Operating lease	Capital lease
D	Operating lease	Operating lease

Q34. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted.

Are unrealized gains and losses on available-for-sale securities reported in the:

	Statement of stockholders' equity	Statement of comprehensive income?
A	No	No
B	No	Yes
C	Yes	No
D	Yes	Yes

SS11-Corporate Finance

Q35. With respect to cash dividend payment procedures, the most likely order of dates is:

- A. payment date followed by ex-dividend date.
- B. payment date followed by holder-of-record date
- C. holder-of-record date followed by declaration date
- D. ex-dividend date followed by holder-of-record date.

Q36. All else equal, for a firm that issues additional debt securities, what is the most likely effect on the firm's:

	Financial leverage?	Financial risk?
A	Increase	Increase
B	Increase	Decrease
C	Decrease	Increase
D	Decrease	Decrease

Q37. Exeter Enterprises wants to repurchase some outstanding shares. Which of the following methods gives them the maximum flexibility and most likely helps to support the price of the shares?

- A. Buying shares back in the open market.
- B. Buying back a fixed number of shares at a fixed price
- C. Announcing a tender offer for the desired number of shares.
- D. Repurchasing by direct negotiation with a major shareholder.

Q39. An investment fund, AFC Investments (AFC), owns 8 percent of the outstanding voting shares of public company. There are several larger voting blocks of shares such that AFC is not assured of being able to elect representation on the Board of directors. The shareholder voting right that would be most beneficial in allowing AFC to ensure their interests are represented on the Board is

- A. proxy voting
- B. cumulative voting
- C. confidential voting
- D. voting for other corporate changes.

SS13/14-Equity Investments

Q40. A security market in which all the bids and asks for a stock are gathered to arrive at a single price that satisfies most of the orders is best described as a:

- A. call market.
- B. dealer market.
- C. primary market
- D. continuous market

Q41 With respect to the analysis of a particular industry's risk and level of competition, will the bargaining power of suppliers most likely increase if:

	Buyers can integrate backwards?	Raw materials are standardized?
A	No	No
B	No	Yes
C	Yes	No
D	Yes	Yes

Q42. Which of the following statements most accurately describes the weak-form Efficient Market Hypothesis(EMH)? The weak-form EMH assumes that security price:

- A. fully reflect all security market information.
- B. adjust rapidly to the release of all public information.
- C. fully reflect all information from public and private sources.
- D. adjust rapidly to the release of all information from nonpublic sources.

Q44. During the Recovery Stage of a country's business cycle, the investments most likely to be considered attractive holdings are that country's

- A. bonds along with commodities.
- B. cyclical stocks along with commodities
- C. interest rate sensitive stocks and bonds
- D. stocks and commercial and industrial real estate.

Q45. An equity analyst has collected the following data for Apollo Television, Inc. for the year 2006:

Common stock (\$2.00 par value. Authorized: 3 million shares; Issued: 2 million shares)	\$4,000,000
Additional paid-in-capital	\$12,000,000
Retained earnings	\$5,000,000
Treasury stock (cost of 200,000 shares repurchased in 2004)	\$3,000,000
Current stock price per share	\$20

The price-to-book ratio for Apollo Television, Inc. is closest to:

- A. 1.8x
- B. 1.9x
- C. 2.0x
- D. 2.2x

SS17-Derivative Investments

Q46. Prior to expiration, the maximum value of an Americana call option and an American put option, respectively, is closest to the:

	American call option	American put option
A	Exercise price	Exercise price
B	Exercise price	Underlying price
C	Underlying price	Exercise price
D	Underlying price	Underlying price

Q47. A plain vanilla interest rate swap is a contract where one party pays a:

- A. fixed interest rate and the counterparty pays a floating rate in a different currency
- B. fixed interest rate and the counterparty pays a fixed rate, both in the same currency
- C. floating interest rate and the counterparty pays a floating rate in a different currency
- D. fixed interest rate and the counterparty pays a floating rate, both in the same currency.

Q48. If left open until expiration, the type of futures contract that is most likely to be settled in cash is

- A. currency.
- B. Eurodollar
- C. commodity
- D. U.S. Treasury bond

SS18-Alternative Investments

Q49 In discussing the characteristics of exchange traded funds (ETFs) in markets where capital gains are taxed, and analyst made the following statements:

Statement 1	Compared to investment in a mutual fund, an investor exposure to taxes on capital gains distributions is lower with an ETF.
Statement 2	Compared to a closed-end investment fund, an ETF is more likely to trade at net asset value.

Are the analyst's statements correct?

	Statement 1	Statement 2
A.	No	No
B	No	Yes
C	Yes	No
D	Yes	Yes

Q50. An investor taking a long position in commodity futures while simultaneously investing in government securities has created a:

- A. Commodity-linked bond.
- B. Commodity-linked equity.
- C. Managed Commodity future portfolio.
- D. Collateralized Commodity future position.

Q51. Compared to investing in a single hedge fund, an individual investing in a fund of funds is least likely to obtain:

- A. lower fees.
- B. more diversification.
- C. better access to successful hedge funds.
- D. a higher lever of expertise in finding good-quality hedge funds.

SS15/16-Fixed Income Investments

Q52. The yield on an industrial bond is 7.59 percent while the yield on a benchmark bond with the same maturity is 5.63 percent. The relative yield spread is closest to:

- A. 2.0%
- B. 25.8%
- C. 34.8%
- D. 74.2%

Q54. A 5 percent coupon bond with a par value of \$1,000 matures in three years and pays interest semiannually. Using an annual discount rate of 4 percent, the price of the bond is closest to:

- A. \$1,014.42.
- B. \$1,028.01
- C. \$1,052.42.
- D. \$1,086.52.

Q55. Do Treasury inflation protection securities (TIPS) issued by the U.S. Department of the Treasury have:

	<u>fixed coupon payment amounts?</u>	<u>fixed par values?</u>
A.	NO	NO
B.	NO	YES
C.	YES	NO
D.	YES	YES

Q56. A 5 percent, semi-annual pay bond with a par value of \$1,000 matures in 10 years and is selling for \$925.61, for a 6 percent yield to maturity. Over the life of the bond, the reinvestment income that must be earned in order to realize the 6 percent yield is closest to:

- A. \$157.63.
- B. \$ 171.75.
- C. \$ 232.02
- D. \$246.14.

Q57. An analyst gathered the following information about two option-free bonds that each have a par value of \$1,000:

	<u>Bond 1</u>	<u>Bond 2</u>
Time to maturity	5years	10years
Annual coupon rate	5.0%	7.0%
Discount rate today	6.0%	6.5%

If the discount rate does not change for either bond, one year from today, which of the following most likely describes the change in price for each bond?

- A. both Bond 1 and Bond 2 will decrease.
- B. both Bond 1 and Bond 2 will increase.
- C. Bond 1 will decrease and Bond 2 will increase.
- D. Bond 1 will decrease and Bond 2 will decrease.

SS12-Portfolio Management

Q58. All else equal, as the correlation of returns among a set of securities decrease, will a portfolio composed of those securities most likely experience an increase in expected:

	<u>Return?</u>	<u>Risk?</u>
A.	NO	NO
B.	NO	YES
C.	YES	NO
D.	YES	YES

Q59. An investor holds a portfolio of two stocks, ABC Inc., and XYZ Corp., and is considering adding the stock of New Company to her portfolio. For diversification purposes, the most important factor for her consider when making this decision is:

- A. New Company's expected return relative to the returns of ABC and XYZ.
- B. The average covariance of New Company's returns with the returns of ABC and XYZ.
- C. The total variance of New Company's returns relative to the variance of returns for ABC and XYZ.
- D. The semivariance of New Company's returns relative to the semivariance of returns for ABC and XYZ.

Q60. Which of the following statements regarding the Markowitz efficient frontier is least likely to be correct? The optimal portfolio for:

- A. a more risk-averse investor will be different from the optimal portfolio for a less risk-averse investor.
- B. an investor is the portfolio that lies on the efficient frontier and provides her with the greatest level utility.
- C. an investor is found at the point of tangency between the efficient frontier and an investor's highest utility curve.
- D. a more risk-averse inverse investor will lie inside the efficient frontier but will lie outside the efficient frontier for a less risk-averse investor.