

2008 Level 1 Sample Exam Volume 1

SS2/3-Quantitative Methods

10. Which of the following changes in sample size and degrees of freedom, respectively, is *most likely* to result in an increase in the width of the confidence interval for the population mean?

	<u>Sample size</u>	<u>Degrees of freedom</u>
A.	Increase	Increase
B.	Increase	Decrease
C.	Decrease	Increase
D.	Decrease	Decrease

14. An analyst determined that approximately 99 percent of the observations of daily sales for a company were within the interval from \$230,000 to \$480,000 and that daily sales for the company were normally distributed. The mean daily sales and standard deviation of daily sales, respectively, for the company were closest to:

	<u>Mean daily sales</u>	<u>Standard deviation of daily sales</u>
A.	\$351,450	\$41,667
B.	\$351,450	\$83,333
C.	\$355,000	\$41,667
D.	\$355,000	\$83,333

SS4/5/6-Economics

17. The demand for a given resource will *most likely* decrease if the prices of substitute resources and complementary resources, respectively:

	<u>Prices of substitute resources</u>	<u>Prices of complementary resources</u>
A.	Increase	Increase
B.	Increase	Decrease
C.	Decrease	Increase
D.	Decrease	Decrease

18. Which of the following types of unemployment is *most likely* to be associated with an economy in which many workers have been made obsolete by changing technology?

- A. Cyclical.
- B. Marginal.
- C. Frictional.

- D. Structural.
19. According to the Philips curve approach, when inflation is less than expected, the most likely initial effect is that:
- A. Real wage rates will fall.
 - B. Real interest rates will fall.
 - C. The natural rate of unemployment will rise.
 - D. Unemployment will rise above its natural rate.
20. The free-rider problem, an obstacle to efficiency, is *most likely* associated with:
- A. Monopolies
 - B. Public goods.
 - C. Subsidies and quotas.
 - D. Price ceilings and price floors.
21. The primary difference between the McCallum rule and the Taylor rule is that the McCallum rule follows the:
- A. Keynesian feedback rule and adjusts the federal funds rate to target the inflation rate.
 - B. Monetarist feedback rule and adjusts the federal funds rate to target the inflation rate.
 - C. Keynesian feedback rule and adjusts the growth rate of the monetary base to target the inflation rate.
 - D. Monetarist feedback rule and adjusts the growth rate of the monetary base to target the inflation rate.

SS7/8/9/10-Financial Statement Analysis

23. 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 9 percent, interest is paid semiannually, and the bond matures in five years. The market rate of interest when the bond was issued was 10 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 <u>initial liability</u> <u>recorded</u>	Interest expense recorded on the <u>first</u> <u>coupon payment date</u>
A.	\$961	\$48
B.	\$961	\$50
C.	\$1,000	\$48
D.	\$1,000	\$50

24. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. An analyst gathered the following data for four profitable companies operating in the same industry:

Company	Deferred Tax Assets	Deferred Tax Liabilities
1	\$50,000	\$200,000
2	\$300,000	\$400,000
3	\$85,000	\$50,000
4	\$170,000	\$115,000

If the applicable corporate income tax rate decreased and nothing else changes, which company will *most likely* experience the largest decrease in reported equity?

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

25. According to U.S. GAAP and IAS GAAP, respectively, is a company required to classify interest paid as cash flow financing in the statement of cash flows?

	<u>U.S. GAAP</u>	<u>IAS GAAP</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

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

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

An analyst has calculated the following ratios for a firm:

Sales/Total Assets	Net Profit Margin (%)	Return on Total Assets (%)	Total Assets/Equity
2.8	4	11.2	1.6

The return on equity for this firm would be closest to:

- A. 4.48%.
- B. 6.40%.
- C. 15.20%.
- D. 17.92%.

30. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. To gain insight into what portion of the company's assets is liquid, an analyst would *most likely* use:

- A. The cash ratio.
- B. The current ratio.
- C. Comparative balance sheets.
- D. Common-size balance sheets.

32. 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.

33. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. Do the International Accounting Standards Board (IASB) conditions that must be met in order for revenue recognition to occur include the:

	<u>Measurement of the costs</u> <u>incurred?</u>	<u>Receipt of payment?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

34. Assume U.S. GAAP (generally accepted accounting principles) applies unless otherwise noted. During a period of declining prices, a company using the LIFO inventory method instead of FIFO would *most likely* report:

- A. Lower current assets and lower gross income.
- B. Lower current assets and higher gross income.
- C. Higher current assets and lower gross income.
- D. Higher current assets and higher gross income.

35. A company that sells ice cream is evaluating an expansion of its production facilities to allow the company to also produce frozen yogurt. The expansion project is based on a marketing study that concluded producing frozen yogurt would increase the company's ice cream sales because of an increase in brand awareness. Should an analyst include the cash flows associated with the expected increase in ice cream sales in the calculation of the project's net present value (NPV)?

- A. No, because the projected increase in ice cream sales is an externality.
- B. No, because the projected increase in ice cream sales is an opportunity cost.
- C. Yes, because the project's NPV will be overstated if the cash flows associated with the projected increase in ice cream sales are not included.
- D. Yes, because the project's NPV will be understated if the cash flows associated with the projected increase in ice cream sales are not included.

36. For two mutually exclusive capital projects with normal cash flows, the NPV and IRR methods will *most likely* produce conflicting rankings when the:

- A. Cost of capital is equal to the crossover rate.
- B. Cost of capital is less than the crossover rate.
- C. Cost of capital is greater than the crossover rate.
- D. Net present value is negative at the crossover rate.

38. An analyst gathered the following information about a company and the company's industry:

	Company	Industry
Accounts receivable turnover	5.6 times	6.5 times
Inventory turnover	4.2 times	4.0 times
Number of days of payables	28 days	36 days

When compared to the industry, the company's:

- | | <u>Operating cycle is?</u> | <u>Cash conversion cycle is?</u> |
|----|----------------------------|----------------------------------|
| A. | shorter | shorter |
| B. | shorter | longer |
| C. | longer | shorter |
| D. | longer | longer |

SS13/14-Equity Investments

39. The values of nearly all bond market indexes are calculated using which of the following conventions for pricing and weighting, respectively?

- | | <u>Pricing</u> | <u>Weighting</u> |
|----|----------------|------------------|
| A. | Trader priced | Price |

- | | | |
|----|---------------|--------------|
| B. | Trader priced | Market value |
| C. | Market priced | Price |
| D. | Market priced | Market value |

41. The efficient market hypothesis implies that fundamental analysis:

- A. Can achieve superior returns by extrapolating historical data.
- B. Is inferior to technical analysis because fundamental analysis is not timely.
- C. Requires the analyst to predict movements in relevant variables that affect rates of return.
- D. Will be successful if transaction costs are minimized by focusing on a limited number of large-capitalization stocks.

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

Net profit margin	5.0%
Total asset turnover	2.0
Financial leverage (Total assets/equity)	2.5
Beta for the company's stock	1.5
Expected rate of return on the market index	10.0%
Risk-free rate of return	5.0%

The analyst expects the information above to accurately reflect the future. If the company wants to achieve a growth rate of at least 15% without changing its capital structure or issuing new equity, the maximum dividend payout ratio for the company would be *closest* to:

- A. 0.0%.
- B. 12.5%.
- C. 40.0%.
- D. 60.0%

43. Emanuel Rodriguez, CFO of Monterrey Spikes Sports Goods Inc., has gathered the following information about the company:

	<u>2000</u>	<u>2007</u>
Sales	\$149.7 million	\$220.0 million
Return on assets (ROA)	10%	12%
Net profit margin (NPM)	6%	7%
Number shares outstanding	5 million	6 million

Rodriguez expects sales in 2008 to grow at the historical compound annual growth of sales from the year 2000 to 2007. For the year 2008, the net profit margin and the number of shares outstanding are expected to remain unchanged from the year 2007. The company's earnings per share (EPS), for the year 2008, is closest to:

- A. \$2.74.
- B. \$2.77.
- C. \$4.69.
- D. \$4.75.

44. Bharath Advanced Technologies, Inc., is a large firm in a competitive industry. The company has above-average investment opportunities and its return on investments has been above the required rate of return. In addition, Bharath has invested heavily in fixed assets and technology to reduce its production costs. The company has also increased its advertising budget substantially to establish a strong brand image for its products. From the above description, Bharath is best characterized as a:

- A. Cyclical company that follow a low-cost strategy.
- B. Speculative company that follows a differentiation strategy.
- C. Growth company that follows a defensive competitive strategy.
- D. Defensive company that follows an offensive competitive strategy.

SS17-Derivative Investments

46. Are principal amounts typically exchanged at the beginning of a(n):

	<u>Interest rate swap?</u>	<u>Currency swap?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

48. Do "margin" in the stock market and "margin" in the futures market, respectively, mean that an investor has received a loan that reduces the amount of his own money required to complete the transaction?

	<u>"Margin" in the stock market</u>	<u>"Margin" in the futures market</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

SS18-Alternative Investments

51. Which real estate valuation approach is *most likely* to require specific information about an investor to estimate the value of a property?

- A. Cost approach.

- B. Income approach.
- C. Sales comparison approach.
- D. Discounted after-tax cash flow approach.

SS15/16-Fixed Income Investments

52. An analyst determines that an 8% option-free bond, maturing in 2015, would experience a 3% change in price of market interest rates rise by 50 basis points. If market interest rates instead fall by 50 basis points, the bond's price would:

- A. Increase by exactly 3%.
- B. Increase by less than 3%.
- C. Decrease by less than 3%.
- D. Increase by more than 3%.

54. The table below summarizes the yields and corresponding prices for a hypothetical 15-year option-free bond that is initially priced to sell at 7% yield:

Yield(%)	Price(\$)
6.90%	100.9254
7.00%	100.0000
7.10%	99.0861

Using a 10 basis point rate shock, the effective duration for this bond is *closest* to:

- A. 4.6 years.
- B. 7.5 years.
- C. 9.2 years.
- D. 15.0 years.

56. A bond portfolio manager owns \$5 million par value of a non-callable bond issue. The duration of the bonds is 5.6 and the current market value of the bonds is \$5,125,000. The dollar duration of the bonds is closest to:

- A. \$125,000.
- B. \$280,000.
- C. \$287,000.
- D. \$700,000.

SS12-Portfolio Management

59. Ken Darge is primarily concerned with growing his portfolio using a balance between capital gains and reinvestment of current income. Jules Young is primarily concerned with achieving an

investment return that is no lower than the rate of inflation. Which of the following objectives is *most* appropriate for:

- | | <u>Ken Darge?</u> | <u>Jules Young?</u> |
|----|----------------------|----------------------|
| A. | Total return | Current income |
| B. | Total return | Capital preservation |
| C. | Capital appreciation | Current income |
| D. | Capital appreciation | Capital preservation |