

2011 Level 1 Sample Exam Volume 1

SS1-Ethics and Professional Standards

1. Abasi Hasina, CFA, signed an employment contract with a non-compete clause restricting him from working for a competitor for three years after leaving the employer, an investment bank. After one year, Hsaina quits his job for a position with an investment bank in a city across the country. The new job pays twice as much as the old one. Lawyers with whom he consulted determined the non-compete clause was a violation of human rights and thus illegal, so he took the offer. Did Hssina most likely violate the CFA Insitute Code of Ethics?
 - A. Yes
 - B. No, the non-compete clause was considered illegal.
 - C. No, the non-compete clause is void since the new position is geographically distant.
2. Benefits of compliance with the CFA Institute Global Investment Performance Standards(GIPS®) least likely include:
 - A. strengthening of internal controls.
 - B. Participation in competitive bidding.
 - C. Elimination of in-depth due diligence for investors.
3. Who is most likely responsible for claiming and maintaining compliance with CFA Institute Global Investment Performance Standards (GIPS®)?
 - A. An independent third party
 - B. The firm claiming compliance
 - C. The risk management department
4. Mariam Musa, CFA, Head of Compliance at Dunfield Brokers, questions her colleague Omar Kassim, a CFA Candidate and a research analyst, about his purchase of shares in a company for his own account immediately before he published a "buy" recommendation. He defends his actions by stating he has done nothing wrong because Dunfield doesn't have any personal trading policies in place. The CFA Institute Code of Ethics and Standards of Professional Conduct were most likely violated by:
 - A. only Musa.
 - B. only Kassim
 - C. both Musa and Kassim.
5. Zhao Xuan, CFA, is a sell side investment analyst. While at a software industry

conference, Xuan hears rumors that Green Run Software may have falsified its financial results. When she returns to her office, Xuan conducts a thorough analysis of Green Run. Based on her research, including discussions with some of Green Run's customers, Xuan is convinced that Green Run's reported 50 percent increase in net income in recent quarters is completely fictitious. So far, however, Xuan is the only analyst that is suspicious about the company's reported earnings. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, the least appropriate action for Xuan is to:

- A. report her suspicions to Green Run's management.
 - B. do nothing, until her analysis is supported by other analysts.
 - C. Recommend that her clients sell their Green Run shares immediately.
6. Richard Cardinal, CFA, is the founder of Volcano Capital Research (VCR), an investment management firm whose sole activity is short selling. Cardinal seeks out companies whose stocks have had large price increases. Cardinal also pays several Washington lobbying firms to update him immediately on any legislative or regulatory changes that may impact his target companies. Cardinal sells short those target companies that he estimates are near the peak of their sales and earnings and that his Washington sources identify as facing legal or regulatory challenges. Immediately after he sells a stock, Cardinal conducts a public relations campaign to disclose all of the negative information he has gathered on the company, even if the information is not yet public. Cardinal then encourages shareholders to file widely publicized shareholder class-action lawsuits that seek damages because the stock dropped in price. Which of Cardinal's following actions is least likely to be in violation of the CFA Institute Standards of Professional Conduct?
- A. Selling stock short
 - B. Trading on information from lobbyists
 - C. Disclosing information about target companies
7. Kirsten Kelso, CFA, is a research analyst at an independent research firm. Kelso is part of a team of analysts who focus on the automobile industry. Recently, Kelso disagreed with two research "sell" recommendations written by her team even though she felt confident the research process was properly conducted. In discussions with several clients, Kelso states "even though my name is on the sell reports, these stocks are a buy because sales and share prices for both auto companies will rise significantly due to strong demand for their vehicles." Concerning the "sell" recommendations, which of Kelso's following actions would most likely violate the CFA Institute Standards of Professional Conduct?
- A. Dissociating from the report
 - B. Distinguishing between fact and opinion
 - C. Sharing her personal opinion of the stocks

8. Gardner Knight, CFA, is a product development specialist at an investment bank. Knight is responsible for creating collateralized debt obligations (CDOs) consisting of residential mortgage bonds. In the marketing brochure for his most recent CDO, Knight provided a list of the mortgage bonds that the CDO was created from. The brochure also states that "an independent third party, the collateral manager, had sole authority over the selection of all mortgage bonds used as collateral in the CDO." However, Knight met with the collateral manager and helped her select the bonds for the CDO. Knight is least likely to be in violation of which CFA Institute Standards of Professional Conduct?
- A. Suitability
 - B. Conflicts of Interest
 - C. Communications with Clients and Prospective Clients
9. Monique Gretta, CFA, is a research analyst at East West Investment Bank. Gretta has several long-standing relationships with mutual funds and institutional investors. Gretta often provides these clients with draft copies of her research before disseminating the information to all of the bank's clients. This practice has helped Gretta avoid several errors in her reports and she believes it is beneficial to the rest of her client base. Regarding her research, Gretta least likely violated the CFA Institute Code of Ethics and Standards of Professional Conduct because:
- A. her report is a draft.
 - B. Of her conflicts of interest
 - C. this practice benefits clients.

SS2/3-Quantitative Methods

10. The stated annual interest rate is 20 percent and the frequency of compounding is monthly. The effective annual rate (EAR) is closest to:
- A. 20%
 - B. 21%
 - C. 22%
11. For a positively skewed unimodal distribution, which of the following measure is most accurately described as the largest?
- A. Mode
 - B. Mean
 - C. Median
12. 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 internal rate of return of the project is closest to:

- A. 4.4%
- B. 5.5%
- C. 19.3%

13. Given the following data, the portfolio return is closest to:

Asset class	Asset allocation (weight) (%)	Asset class return (%)	Correlation with equities class (%)
Equities	45	16	100
Mortgages	25	12	30
Cash and equivalents	30	2	10

- A. 8.2%
- B. 10.0%
- C. 10.8%

14. Rank the following portfolios based on their Sharpe ratios. The risk-free rate is 4 percent.

Portfolio	Mean return on the portfolio (%)	Standard deviation of the return on the portfolio (%)
A	10	20
B	18	15
C	6	3

Which portfolio has the *highest* Sharpe ratio?

- A. Portfolio A
- B. Portfolio B
- C. Portfolio C

15. If two events, A and B, are independent and the probability of A does not equal the probability of B (i.e., $P(A) \neq P(B)$), then the probability of event A given that event B has occurred (i.e., $P(A|B)$) is most accurately described as:

- A. $P(A)$
- B. $P(B)$
- C. $P(A|B)$

16. The following sample of 20 items is selected from a population. The population variance is unknown.

10	20	-8	2	-9
5	0	-8	3	21
-11	5	3	7	11
-5	-8	12	-6	6

The Standard error of the sample mean is *closest* to:

- A. 2.1.
- B. 2.5.
- C. 9.4.

SS4/5/6-Economics

17. Consumer surplus is best described as being:

- A. always less than or equal to zero.
- B. always greater than or equal to zero.
- C. at times positive and at other times negative.

18. A local laundry and dry cleaner collects the following data on its workforce productivity. Workers always work in teams of two. The laundry charges \$3.00 to launder a shirt (revenue is \$3.00 per 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

19. Holding the working-age population constant, if the labor force participation rate

- declines while the number of people employed remains unchanged, the unemployment rate is most likely to:
- A. increase
 - B. decrease
 - C. remain unchanged.
20. Which of the following actions on the part of a central bank is most consistent with increasing the quantity of money?
- A. Selling securities on the open market
 - B. Increasing the required reserve ratios
 - C. Purchasing securities on the open market
21. Perfect price discrimination is best described as pricing that allows producers to increase their economic profit while consumer surplus:
- A. increase
 - B. decreases
 - C. remains steady.
22. Which of the following multipliers is least likely to be part of fiscal policy?
- A. Money multiplier
 - B. Balanced budget multiplier
 - C. Government expenditure multiplier

SS7/8/9/10-Financial Statement Analysis

23. 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 it has prepared the financial statements according to generally accepted accounting principles.
24. 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. unearned revenue.

25. At the beginning of the year, a company had total shareholders' equity consisting of ¥50,000 in retained earnings.

During the year, the following events occurred:

	¥
1. Net income reported	42,000
2. Dividend paid	7,000
3. Realized loss on available-for-sale investments	3,000
4. Foreign currency translation gain on foreign subsidiaries	8,000
5. 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. ¥268,000
- B. ¥284,000
- C. ¥287,000

26. A company's comparative income statements and balance sheets are presented below.

Income Statement for the year ended 31 August (U.S.\$ thousands)		
	<u>2009</u>	<u>2008</u>
Sales	\$100,000	\$95,000
Cost of goods sold	<u>47,000</u>	<u>47,500</u>
Gross profit	53,000	47,500
Operating expenses	34,000	38,000
Interest expense	<u>2,400</u>	<u>2,700</u>
Earnings before taxes	16,600	6,800
Income taxes 33%	<u>5,478</u>	<u>2,244</u>
Net Income	<u>\$ 11,122</u>	<u>\$ 4,556</u>

Balance Sheet as at 31 August (U.S.\$ thousands)		
	<u>2009</u>	<u>2008</u>
Assets		
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

Total long-term assets	72,000	80,000
Total Assets	\$131,122	\$127,000

Liabilities		
Accounts payable	\$ 15,000	\$ 15,000
Other current liabilities	7,000	9,000
Total current liabilities	\$ 22,000	\$ 24,000
Long-term debt	35,000	40,000
Total liabilities	\$ 57,000	\$ 64,000
Shareholders' equity		
Common stock	\$ 58,000	\$ 58,000
Retained earnings	16,122	5,000
	\$ 74,122	\$ 63,000
Total Liabilities &Equity	\$ 131,122	\$127,000

The cash collected from customers in 2009 is closest to:

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

27. 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	44,488	13.1
Sales	400,000	100.0
Total assets	524,488	131.0
Total equity	296,488	74.0
ROE	14.5%	17.7%

The main driver of the company's inferior ROE compared to that of the industry is *most likely* the result of its lower:

- A. EBIT margin
- B. tax burden ratio
- C. Interest burden ratio

28. Which of the following is least likely to be a fundamental principle in the preparation of financial statements within the IFRS Framework?

- A. Matching
- B. Materiality
- C. Accrual basis

29. The following information is available about a company:

(all figures in \$ thousands)	2010	2009
Deferred tax assets	200	160
Deferred tax liabilities	(450)	(360)
Net deferred tax liabilities	(250)	(200)
Earning before taxes	4,000	3,800
Income taxes at the statutory rate	1,200	1,140
Income tax payable (Current income tax expense)	1,000	900

The company's 2010 income tax expense (in thousands) is closest to:

- A. \$1,000
 - B. \$1,050
 - C. \$1,250
30. 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
31. 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 depreciation taken.
 - C. held for use disposal with depreciation continuing to be taken,

32. The following information is available from a company's 2010 financial statements:

Note 6: Employee costs

(all figures in \$ thousands)	2010	2009
Wages and salaries	\$21,000	\$18,500
Share-based payment costs (Note 15)	600	425
Defined contribution pension plan	1,525	1,462
Retirement benefit obligations (Note 17)	728	620

Other employee costs	3,233	3,080
Total employee costs	\$27,086	\$24,087

Note 17: Retirement benefit obligations

Amounts recognized in the income statement for the year

(all figures in \$ thousands)	2010	2009
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	6	12
Total income statement charge	\$720	\$620

The pension expense (thousands) reported in 2010 is closest to:

- A. \$1,525
- B. \$2,217
- C. \$2,253

33. Given the following information about a company:

(all figures in \$ millions)	2010	2009
Short-term borrowings	\$2,240	\$5,400
Current portion of long-term interest-bearing debt	2,000	1,200
Long-term interest-bearing debt	12,000	9,000
Total shareholders' equity	23,250	21,175
EBIT	3,850	3,800
Interest payments	855	837
Operation lease payments	800	800

What is the most appropriate conclusion an analyst can make about the solvency of the company? Solvency has:

- A. improved because the debt-to-equity ratio decreased.
- B. deteriorated because the debt-to-equity ratio increased.
- C. improved because the fixed charge coverage ratio increased.

34. Which of the following will most likely increase a company's operating cash flow? An increase in:

- A. days sales payable (DSP).
- B. gains on the sale of long-term assets.
- C. Use of operating leases versus financing leases.

35. 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

36. A firm's estimated costs of debt, preferred stock, and common stock are 12 percent, 17 percent, and 20 percent, respectively. Assuming equal funding from each source and a 40 percent tax rate, the weighted average cost of capital is closest to:

- A. 9.8%
- B. 13.9%
- C. 1437%

37. A project has the following annual cash flows:

Year 0	Year 1	Year 2	Year 3
-\$606,061	\$2,151,515	-\$2,542,424	\$1,000,000

Which discount rate most likely provides a positive net present value?

- A. 15%
- B. 18%
- C. 21%

38. Based on a need to borrow \$2 million for one month, which of the following alternatives has the least expensive effective annual cost?

- A. A banker's acceptance with an all-inclusive annual rate of 6.1%
- B. A credit line at 6.0% annually with a 0.5% annual commitment fee
- C. Commercial paper at 5.9% annually with a dealer's commission of \$3,000 (or 0.15%) and a backup line cost of \$4,000 (or 0.20%)

39. Given the following 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

The company's degree of operating leverage is closest to:

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

40. 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.

41. 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.

SS13/14-Securities Markets and Equity Investments

42. 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

43. An investor uses the data below and the constant growth model to evaluate a company's common stock. To estimate growth, she uses the average value of the:

1. dividend growth rate over the period 2004-2009 and
2. sustainable growth rate for the year 2009

Year	EPS	DPS	ROE
2009	\$3.20	\$1.92	12%
2008	\$3.60	\$1.85	17%
2007	\$2.44	\$1.74	13%
2006	\$2.08	\$1.62	15%
2005	\$2.76	\$1.35	11%
2004	\$2.25	\$1.25	9%

If her required return is 15 percent, the stock's estimated value is closest to:

- A. \$23.71
- B. \$25.31
- C. \$30.14

44. Which of the following is least likely to be directly reflected in the returns on a commodity index?

- A. Roll yield
- B. Risk-free interest rate
- C. Changes in the underlying commodity's price

45. The following data pertains to a margin purchase of a stock by an investor.

Stock's purchase price	\$50/share
Sale price	\$55/share
Shares purchased	500
Margin	45%
Call money rate	6%
Dividend	\$1.80/share
Transaction commission on purchase	\$0.05/share
Transaction commission on sale	\$0.05/share

If the stock is sold exactly one year after the purchase, the total return on the investor's investment is closest to:

- A. 14%
- B. 19%
- C. 22%

SS17-Derivatives

46. Derivative markets serve a number of purposes in global economic systems. Which of the following is least likely one of these purposes?

- 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
47. 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. \$100
48. A portfolio manager enters into an equity swap with a swap dealer. The portfolio manager pays the return on the Value index and, in return, receives the return on the Growth index.

The swap's notional principal is \$50 million and the payments will be made semiannually. 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 payment due after 6 months is closest to:

- A. \$587,158
 - B. \$1,007,326
 - C. \$1,427,494
- SS18-Alternative Investments**
49. A mutual fund with a 2.0 percent sales charge and 0.75 percent annual expense, earns 6.0 percent annually for 4 years. At the end of year 4, the NAV calculation most likely reflects:
- A. a deduction of the sales charge and annual expenses at $t=0$
 - B. the compounded return, net of expenses, after deducting the sales charge at $t=0$
 - C. the compounded return after deducting the compounded sales charge and annual expenses.
50. 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.
51. When market participants expect the spot price of a commodity to be higher to be higher in the future, the commodity market is said to be in:
- A. contango.
 - B. full carry
 - C. backwardation.

SS15/16-Fixed Income Investments

52. Which of these embedded options most likely benefits a bondholder?
- A. The floor in a floating-rate security
 - B. An accelerated sinking fund provision
 - C. The call option in a fixed-rate security
53. Consider two bonds that are identical except for their coupon rates. The bond that will have the highest interest rate risk most likely has the:
- A. lowest coupon rate
 - B. higher coupon rate
 - C. coupon rate closest to its market yield.
54. Duration is not an accurate measure of yield-curve risk for a bond portfolio because it:
- A. can be applied only to measure the risk of a single bond.
 - B. Assumes that the yield for all maturities change by the same amount.
 - C. Measures the impact of a change in the short-term, riskless rate of interest.
55. An investor whose marginal tax rate is 33.5 percent is analyzing a tax-exempt bond offering a yield of 5.02 percent. The taxable equivalent yield of the bond is closest to:
- A. 3.46%
 - B. 6.94%
 - C. 7.82%
56. If the yield on a 5-year U.S. corporate bond is 7.39 percent and the yield on a 5-year U.S. Treasury note is 4.26 percent, the relative yield spread of the bond is closest to:

- A. 3.13%
- B. 42.4%
- C. 73.5%

57. Consider a \$100 par value bond, with an 8 percent coupon paid annually, maturing in 20 years. If the bond currently sells for \$96.47, the yield to maturity is closest to:

- A. 8.29%
- B. 8.37%
- C. 8.93%

SS12-Portfolio Management

58. Which of the following types of institutions is most likely to have a long investment time horizon and a high level of risk tolerance?

- A. A bank
- B. An endowment
- C. An insurance company

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

Stock	Standard Deviation	Correlation of Returns ¹	Portfolio Weights
Cable Incorporated	30%	0.65	68%
GPT Company	20%		32%

¹Correlation of returns between Cable Incorporated and GPT Company

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

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

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

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