

## 2006 Level 1 Sample Exam Volume 4

### SS1-Ethics and Professional Standards

6 Establishing policies and procedures with respect to portfolio diversifications is a compliance procedure relating most directly to the CFA Institute Standard of Professional Conduct about;

- A fiduciary duties
- B prohibition against plagiarism
- C responsibilities to the employer
- D prohibition against misrepresentation

7 Does the CFA Institute Standard of Professional Conduct with respect to research reports apply when such reports are disseminated in:

	Telephone conversation?	Media broadcasts?
A	No	No
B	No	Yes
C	Yes	No
D	Yes	Yes

8 The GIPS standards set forth required verification procedures relating to;

- A composite construction but not nondiscretionary accounts.
- B nondiscretionary accounts but not composite construction.
- C both composite construction and nondiscretionary accounts
- D neither composite construction nor nondiscretionary accounts.

9 Samuel Takeda, CFA, is chief executive officer of SMI Investing. SMI has a soft dollar arrangement with a broker. Takeda directed the broker to pay invoices submitted by Toma Associates. The invoices are for a small amount of research for SMI and compensation to Toma's principal for his efforts in making substantial client referrals to Takeda in SMI's early years. According to the Standards of Practice Handbook, Takeda may use the soft dollars to pay;

- A the invoices in full
- B for the research only
- C the invoices in full only if SMI is getting best price and execution from the broker
- D the invoices in full only if the commission paid is reasonable in relation to the services received.

### SS2/3-Quantitative Methods

14 A lognormal distribution differs from a normal distribution in that a lognormal distribution;

- A is skewed to the left
- B cannot contain negative values
- C has less complicated confidence intervals
- D is completely described by two parameters.

**SS4/5/6-Economics**

19 Which of the following best characterizes the short run supply of:

	Mobile resources?	Immobile resources?
A	Elastic	Elastic
B	Elastic	Inelastic
C	Inelastic	Elastic
D	Inelastic	Inelastic

20 Which of the following is most likely to reduce the usefulness and reliability of an economy's money supply data?

- A. A decrease in the use of debit cards
- B. A decrease in the desire by households to hold currency
- C. A decrease in the purchase of no-load stock and bond mutual funds
- D. An increase in legal restrictions imposed by other countries limiting the domestic use of foreign currencies

21 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

22 Which of the following fiscal policy models is most likely to support the conclusion that government budget deficits will stimulate aggregate demand?

- A Keynesian
- B Supply-side
- C New classical
- D Crowding-out

**SS7/8/9/10-Financial Statement Analysis**

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

Company	Average Inventory	Sales	Average Inventory
	(millions)	(millions)	Processing Period
Aro	\$2.0	\$25	60
Burr	\$2.0	\$26	70
Curtis	\$2.5	\$28	60
Dobbie	\$2.5	\$29	70

- A. Aro
- B. Burr
- C. Curtis
- D. Dobbie

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

A company that is a lessee is currently negotiating several new leases. Compared to operating leases, structuring the new leases as capital leases will most likely result in the company experiencing:

- A lower cash flow
- B higher net income
- C a higher interest coverage ratio
- D a lower return on total assets ratio

**SS11-Corporate Finance**

35. An analyst gathered the following information related to the annual expected cash flows for a proposed expansion project:

Revenue	\$420,000
Labor and material costs	\$120,000
Depreciation	\$40,000
Tax rate	40%

The company plans to use a building that it has owned for several years to accommodate the equipment needed for the expansion project. The company estimates that the building could be rented to another firm for \$30,000 a year if it is not used for the expansion project. The rental income is not included in any of the information gathered by the analyst.

To determine the project's net present value, the amount of annual not operating cash flow for the expansion is closest to:

- A \$166,000
- B \$178,000
- C \$184,000
- D \$196,000

38. A company is totally financed by common equity, but is considering whether to replace 30 percent of its common equity long-term debt. The indifference point for the two alternative capital structures occurs at a sales level of \$8 million. If expected sales for the company are \$7 million, which of the following statements about the company's earnings before interest and taxes (EBIT) and earnings per share (EPS) is most accurate? Compared to using only common equity in the capital structure, using financial leverage will:

- A increase both EBIT and EPS
- B increase EBIT and decrease EPS
- C have no effect on EBIT and increase EPS
- D have no effect on EBIT and decrease EPS

39. With respect to project risk, is stand-alone risk most likely to have a high correlation with:

	Corporate risk?	Market risk?
A	No	No
B	No	Yes
C	Yes	No
D	Yes	Yes

### SS13/14-Equity Investments

41. An analyst gathered the following information for a stock-market series and a client:

Beginning of year value for the series	436
Expected dividend payment next year	21.75
Client's required rate of return	9%

To earn a return equal to the client's rate of return, the stock-market series must have a year ending value closest to:

- A. 453
- B. 475

- C. 497  
D. 499

42. An internally efficient security market is most accurately characterized as a market in which:

- A assets can be bought or sold quickly  
B the cost of a transaction is minimized  
C an asset's price reflects all available information about the asset  
D prices do not change much from one transaction to the next in the absence of new information

45. To estimate the required rate of return for the dividend discount model, the least appropriate input is:

- A a risk premium  
B the expected rate of inflation  
C the growth rate of earnings and dividends  
D the economy's real risk-free rate of return

### SS17-Derivative Investments

47. Which of the following uncovered position is most likely to have a graph that looks like the graph for a :

	Protective put?	Covered call?
A	Long call	Long put
B	Long call	Short put
C	Short call	Long put
D	Short call	Short put

### SS18-Alternative Investments

51. Compared to investment in a single hedge fund, investment in a fund of fund will most likely result in a decrease in:

- A diversification  
B expected return  
C management fees  
D selection and survivorship bias

**SS12-Portfolio Management**

59. For a given common stock, an increase in the business risk of the issuing company would most likely result in which of the following changes with respect to the security market line (SML)?

- A. An upward shift in the SML
- B. A downward shift in the SML
- C. Movement upward along the SML
- D. Movement downward along the SML