2010 Level I Mock Exam: Afternoon Session

The afternoon session of the 2010 Level I Chartered Financial Analyst® Mock Examination has 120 questions. To best simulate the exam day experience, candidates are advised to allocate an average of 1.5 minutes per question for a total of 180 minutes (3 hours) for this session of the exam.

Questions	**Topic**	**Minutes**
1-18	Ethical and Professional Standards	27
19-32	Quantitative Methods	21
33-44	Economics	18
45-68	Financial Statement Analysis	36
69-78	Corporate Finance	15
79-90	Equity Investments	18
91-96	Derivative Investments	9
97-108	Fixed Income Investments	18
109-114	Alternative Investments	9
115-120	Portfolio Management	9
	Total:	**180**

Questions 1 through 18 relate to Ethical and Professional Standards.

1. Alexander Newton, CFA, is the chief compliance officer for Mills Investment Limited. Newton institutes a new policy requiring the pro rata distribution of new security issues to all established discretionary accounts for which the new issues are appropriate. The policy also provides for the distribution of new issues to newly established discretionary accounts where appropriate after their one-month anniversary date. This policy is disclosed to all existing and potential clients. Did Newton violate any CFA Institute Standards of Professional Conduct?

   A. No.
   B. Yes, because the distribution policy should treat all discretionary accounts equally.
   C. Yes, because disclosure of inequitable allocation methods does not fulfill the duty for fair and equitable trade allocation procedures.

2. When Jefferson Piedmont, CFA, joined Branch Investing, Branch began using a quantitative stock selection model Piedmont had developed on his own personal time prior to his employment with Branch. One year later when Piedmont left the firm, he found the original copy of the model he had developed in a file at his home and presented it to his new employer, who immediately began using the model. According to the *Standards of Practice Handbook*, did Piedmont violate any CFA Institute Standards of Professional Conduct?

   A. No.
   B. Yes, because he misappropriated property now belonging to Branch.
   C. Yes, because he failed to inform his new employer the model was the same one used by his previous employer.

3. Lawrence Hall, CFA, and Nancy Bishop, CFA, began a joint research report on Stamper Corporation. Bishop visited Stamper's corporate headquarters for several days and met with all company officers. Prior to the completion of the report, Bishop was reassigned to another project. Hall utilized his and Bishop's research to write the report but did not include Bishop's name on the report, because she did not agree with Hall's conclusion included in the final report. According to the CFA Institute *Standards of Practice Handbook*, did Hall violate any CFA Institute Standards of Professional Conduct?

   A. No.
   B. Yes, with respect to misrepresentation.
   C. Yes, with respect to diligence and reasonable basis.

4. According to the Global Investment Performance Standards (GIPS), which of the following is **not** a part of the verification process? Testing whether the:

   A. firm has complied with all the composite construction requirements.
   B. verification is undertaken by the compliance department in the absence of a third party.
   C. firm's processes and procedures are designed to calculate results in compliance with GIPS standards.

5. Umi Grabbo, CFA, is a highly regarded portfolio manager for Atlantic Advisors (AA), a mid-sized mutual fund firm investing in domestic securities. She has watched the hedge fund boom and on numerous occasions suggested her firm create such a fund. Senior management has refused to commit resources to the area. Attracted by potential higher fees associated with hedge funds, Grabbo and several other employees organize a hedge fund to invest in international securities. Grabbo is careful to work on the fund development only on her own time. Because AA management thinks hedge funds are a fad, she does not inform her supervisor about the hedge fund creation. According to the *Standards of Practice Handbook,* Grabbo should *most likely* address which of the Standards immediately?

   A. Disclosure of Conflicts.
   B. Priority of Transactions.
   C. Additional Compensation Arrangements.

6. David Donnigan enrolled to take the Level II CFA examination in the current year, however he did not take the exam. Donnigan advised his employer he passed Level II. Subsequently, he registered to take the Level II exam the next year. Which CFA Institute Standard of Professional Conduct did Donnigan *least likely* violate?

   A. Duty to employer.
   B. Professional misconduct.
   C. Referencing Candidacy in the CFA Program.

7. Jeffrey Jones passed the Level I CFA examination in 1997 and the Level II examination in 2009. He is not currently enrolled for the Level III examination. According to the CFA Institute Standards of Professional Conduct, which of the following is the *most* appropriate way for Jones to refer to his participation in the CFA Program?

   A. Jeffrey Jones, CFA (expected 2011).
   B. Candidate in the CFA Institute CFA Program.
   C. Passed Level II of the CFA examination in 2009.

8. Rebecca Wong is enrolled to take the Level I CFA examination. Her friend William Leung had purchased Level I study materials from a well-known CFA review program the previous year. Leung made a photocopy of the previous year's copyrighted materials and sold it to Wong to help her study. Who violated the CFA Institute Code of Ethics or any Standards of Professional Conduct?

   A. Both violated.
   B. Neither violated.
   C. Only Leung violated.

9. Nicholas Bennett, CFA, is a trader at a stock exchange. Another trader approached Bennett on the floor of the exchange and verbally harassed him about a poorly executed trade. Bennett in response pushed the trader and knocked him to the ground. The exchange, after investigation, cleared Bennett from any wrongdoing. Which of the following *best* describes Bennett's conduct in relation to the CFA Institute Code of Ethics or Standards of Professional Conduct? Bennett:

   A. did not violate any Code or Standard.
   B. violated the Professional Misconduct Standard.
   C. violated both Misconduct and Integrity of Capital Markets Standards.

10. Albert Nyakenda, CFA, was driving to a client's office where he was expected to close a multi-million dollar deal, when he was pulled over by a traffic policeman When Nyakenda, realized the policeman planned to wrongly ticket him for speeding, he offered to buy him "lunch" so that he could quickly get to his client's office. The alternative was to go to the police station and file a complaint of being wrongly accused that would also involve going to court the next day to present his case. The lunch would cost significantly more than the ticket. Did Nyakenda violate the CFA Code of Ethics?

   A. Yes.
   B. No, because he was wrongly accused.
   C. No, because the cost of lunch is more than the ticket.

11. Delaney O'Keefe, a CFA candidate, is a portfolio manager at Bahati Management Company. The company is considering investing offshore for the first time, particularly in North America, on behalf of their clientele, whom are all high net worth individuals. O'Keefe does not have experience in offshore investments so she hires Mark Carlson, CFA of Carlson Consulting on the basis of his CFA Charter, to undertake due diligence exercises on the top ten portfolio managers in North America, ranked by Assets under Management (AUM). To avoid violating any Code and Standards, O'Keefe should *most likely* undertake:

    A. a sampling of the suitability of North America for clients.
    B. a due diligence exercise on Mark Carlson and Carlson Consulting.
    C. the due diligence exercise on the top ten asset managers herself.

12. Reiko Kimisaki, CFA, is an investment advisor for a national social security fund in a frontier market with a very limited and illiquid capital market and a very young labor force with an investment time horizon of 25 – 30 years. She has been asked to suggest ways to increase the investment return of the overall portfolio. After careful assessment of the Fund's previous investment history, and available asset classes, she considers investment in private equity. What is Kimisaki's *lowest* priority to avoid any Code of Ethics and Standards of Professional Conduct violations prior to making this investment recommendation?

    A. Assess the risk tolerance of the Fund.
    B. Analyze the expected returns of private equity in the market.
    C. Determine if the Investment Policy Statement allows for alternative investments.

13. While waiting in the business class lounge before boarding an airplane, Becca Msafari, CFA, an equity analyst, overhears a conversation by a group of senior managers, including members of the Board, from a large publicly listed bank. The managers discuss staff changes necessary to accommodate their regional expansion plans. Msafari heard several staff names mentioned. Under what circumstances could Msafari *most likely* use this information when making an investment recommendation to her clients?

    A. Under no circumstances.
    B. If she does not breach the confidentiality of names of staff.
    C. If the discussed changes are unlikely to affect the public perception of the bank.

14. Norman Bosno,,CFA acts as an outside portfolio manager to a Sovereign Wealth Fund. Raphel Palmeti, a Fund Official, approaches Bosno to interest him in investing in Starlite Construction Company. He tells Bosno if he approves a two million dollars investment in Starlite by the Fund Bosno will receive a "bonus" that will make him wealthy. Palmeti also adds if Bosnoviak decides not to invest, he will lose the Fund account. After doing a quick and simple analysis, Bosno determines the investment is too risky for the Fund. If Bosno agrees to make the investment what Standard is *least* likely to be violated?

    A. Loyalty, Prudence and Care
    B. Diligence and Reasonable Basis.
    C. Additional Compensation Arrangements.

15. Francesca Ndenda, CFA and Grace Rutabingwa work for New Age Managers where Rutabingwa reports to Ndenda on a daily basis, working in the same department. It has come to the attention of Ndenda that Rutabingwa received a Notice of Enquiry from the Professional Conduct Program at the CFA Institute regarding a potential cheating violation when he sat for the CFA exam in June. As Rutabingwa's supervisor, Ndenda is afraid the behavior of Rutabingwa will be seen as a violation of the CFA Code and Standards. Does Ndenda have cause for concern?

    A. Yes.
    B. No, because her responsibilities do not apply.
    C. No, not until Rutabingwa is found guilty of cheating.

16. Jean-Luc Schlumberger, CFA, is an independent research analyst providing equity research on companies listed on exchanges in emerging markets. He often incorporates statistical data he obtained from the web sites of the World Bank and the Central Banks of the various countries into the body of his research reports. While not indicated within the reports, whenever his clients ask where he gets his information he informs them the information is in the public domain, so he doesn't keep his own records. When the clients ask for the specific web site addresses he provides the information. Which Standard has Schlumberger *most likely* violated?

    A. Misconduct.
    B. Record Retention.
    C. Misrepresentation.

17. Oni Erobo, CFA, is the General Partner in a real estate development project and is responsible for completing the project within an 18-month period and within budget. Erobo is expected to receive equity of 20% if the project comes within budget. Concerned that project costs would escalate, the Limited Partners require Erobo to cap expenses at 15% above budget. Costs were within expectation up until the last month of construction when costs of imported lighting fixtures (accounting for roughly 5% of total costs) escalated by more than 50%. As a result, the overall return declined below the partners expected 35% ROI. Erobo did not inform the Limited Partners about the increased costs. Did Erobo violate the CFA Code of Ethics and Standards of Professional Conduct?

    A. No.
    B. Yes, because returns are lower than expected by the Partners.
    C. Yes, because he did not disclose the increased costs to his Partners.

18. A Central Bank fines a commercial bank for not following statutory regulations with regard to making specific non-performing loan provisions on three loans. Louis Marie Buffet, CFA, sits on the Board of Directors of the Commercial Bank as a non-executive director, representing minority shareholders. He also chairs the internal audit committee of the bank that determines the provisioning policy of the bank. Mercy Gatabaki, CFA is the bank's external auditor and follows international auditing standards whereby she tests the loan portfolio by randomly selecting loans to check for compliance in all aspects of Central Bank regulations. Which Charterholder is *most likely* in violation of the Code and Standard?

    A. Both.
    B. Buffet.
    C. Gatabaki.

Questions 19 through 32 relate to Quantitative Methods

19. An increase in which of the following items is *most likely* to result in a wider confidence interval for the population mean?

    A. Sample size
    B. Reliability factor
    C. Degrees of freedom

20. The joint probability of returns, for securities A and B, are as follows:

Joint Probability Function of Security A and Security B Returns (Entries are joint probabilities)		
	Return on security B=30%	*Return on security B=20%*
Return on security A= 25%	0.60	0
Return on security A= 20%	0	0.40

    The covariance of the returns between securities A and B is *closest* to:

    A. 3.
    B. 12.
    C. 24.

21. An analyst determines that approximately 99 percent of the observations of daily sales for a company are within the interval from $230,000 to $480,000 and that daily sales for the company are normally distributed. The standard deviation of daily sales (in $) for the company is *closest* to:

    A. 41,667.
    B. 62,500.
    C. 83,333.

22. The *least* accurate statement about measures of dispersion for a distribution is that the:

    A. range provides no information about the shape of the data distribution.
    B. arithmetic average of the deviations around the mean will always be equal to one.
    C. mean absolute deviation will always be less than or equal to the standard deviation.

23. An analyst gathers the following information ($ millions) about the performance of a portfolio:

Quarter	*Value at Beginning of Quarter (prior to inflow or outflow)*	*Cash Inflow (Outflow) At Beginning of Quarter*	*Value at End of Quarter*
1	2.0	0.2	2.4
2	2.4	0.4	2.6
3	2.6	(0.2)	3.2
4	3.2	1.0	4.1

The portfolio's annual time-weighted rate of return (%) is *closest* to:

A. 8.
B. 27.
C. 32.

24. A mutual fund manager wants to create a fund based on a high-grade corporate bond index. She first distinguishes between utility bonds and industrial bonds; she then, for each segment, defines maturity intervals of less than 5 years, 5 to 10 years, and greater than 10 years. For each segment and maturity level, she classifies the bonds as callable or non-callable. She then selects bonds from each of the subpopulations she has created. For the manager's sample, which of the following *best* describes the sampling approach?

A. Systematic
B. Simple random
C. Stratified random

25. An analyst conducts a significance test to determine if the relation between two variables is real or the result of chance. His null hypothesis is that the population correlation coefficient is equal to zero and his alternative hypothesis is that the population correlation coefficient is different from zero. He gathers the following information:

Value of the test statistic	2.8092
Critical value at the 0.05 significance level	1.96
Critical value at the 0.01 significance level	2.58

The analyst *most likely* conducted a:

A. one-tailed test and can reject his null hypothesis.
B. two-tailed test and can reject his null hypothesis.
C. two-tailed test and cannot reject his null hypothesis.

26. The null hypothesis is *most* appropriately rejected when the *p*-value is:

    A. negative.
    B. close to one.
    C. close to zero.

27. Under which measurement scale is data *most likely* categorized without being ranked?

    A. Ordinal
    B. Nominal
    C. Interval

28. On 7 January 2008, an investor purchases 100 shares of stock for $32.50 a share. On 7 January 2009, the investor purchases 100 more shares of the same stock for $36.70 a share. On 7 January 2010, the investor sells all 200 shares of the stock for $42.00 a share. The internal rate of return for this investment is *best* described as an example of a:

    A. geometric mean return.
    B. time-weighted rate of return.
    C. money-weighted rate of return.

29. A 180-day U.S. Treasury bill has a holding period yield (HPY) of 2.375%. The bank discount yield (in %) is *closest* to :

    A. 4.640.
    B. 4.750.
    C. 4.875.

30. The sample variance based on the following data points: -6.0 percent, 5.8 percent, 8.4 percent, and 9.7 percent is *closest* to:

    A. 0.000360.
    B. 0.003855.
    C. 0.005140.

31. An analyst determines that 60 percent of all U.S. pension funds hold hedge funds. In evaluating this probability, a random sample of 10 U.S. pension funds is taken. Using the binomial probability function, $P(X = x) = \frac{n!}{(n-x)!x!}\, p^x(1-p)^{n-x}$, the probability (in %) that exactly 6 of the 10 firms in the sample hold hedge funds is *closest to*:

A. 25.08.
B. 27.99.
C. 60.00.

32. An energy analyst forecasts that the price per barrel of crude oil five years from now will range between USD$175 and USD$205. Assume oil prices are a continuous uniform distribution. Recall that the cumulative distribution function for a continuous uniform variable is:

$$\mathrm{F}(x) = \begin{cases} 0 & for\ x \le a \\ \frac{x-a}{b-a} & for\ a < x < b \\ 1 & for\ x \ge b \end{cases}$$

The probability (in %) that the price will be less than USD$180 five years from now is *closest to*:

A. 5.6.
B. 16.7.
C. 44.4.

Questions 33 through 44 relate to Economics

33. For a firm in perfect competition, as the quantity of labor increases, the marginal revenue product *most likely* diminishes because of a decline in:

    A. marginal product only.
    B. marginal revenue only.
    C. both marginal product and marginal revenue.

34. If a price cut of a product increases total revenue, demand is *best* described as:

    A. elastic.
    B. inelastic.
    C. unit elastic.

35. 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. Frictional
    C. Structural

36. The free-rider problem, an obstacle to efficiency, is *most likely* associated with:

    A. monopolies.
    B. public goods.
    C. subsidies and quotas.

37. An expansionary fiscal policy is *least likely* to include an increase in:

    A. tax rates.
    B. government borrowing.
    C. government expenditures.

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

    A. a price increase and the seller pays the entire tax.
    B. a price increase and the buyer pays the entire tax.
    C. no change in price and the seller pays the entire tax.

39. A company determines that the quantity demanded of a product increases by 5% when price is reduced by 10%. The product's price elasticity of demand is *best* described as:

A. elastic.
B. inelastic.
C. perfectly elastic.

40. In perfectly competitive industries what is the *most likely* final long-run effect of a permanent decrease in demand?

A. Price decreases.
B. Economic profit decreases.
C. The number of firms decreases.

41. If a regulatory agency sets prices equal to a monopoly's long-run average cost (LRAC), the monopoly will *most likely* have economic profit that is:

A. zero.
B. positive.
C. negative.

42. When rent controls limit rents to prices below equilibrium prices, which of the following is *most likely* to occur?

A. New housing construction expands.
B. Long-time tenants extract significant benefit from landlords.
C. Newcomers are given preferential entry into rent-controlled apartments.

43. Consider the following information regarding consumer price index (CPI) numbers for this year and last year.

CPI this year	267.54
CPI last year	261.25

The inflation rate (in %) for the period is *closest* to:

A. 2.35.
B. 2.38.
C. 2.41.

44. The quantity theory of money is *best* described as the proposition that, in the long run, an increase in the quantity of money brings a percentage increase in the price level that is:

A. equal.
B. lower.
C. higher.

Questions 45 through 68 relate to Financial Statement Analysis

45. According to the International Financial Reporting Standards framework, which of the following qualities of financial information is *least likely* to improve its reliability?

    A. Neutrality
    B. Consistency
    C. Substance over form

46. The following information is available about a company ($ millions):

Year ended 31 December	**2009**	**2008**
Sales	322.8	320.1
Net income	27.2	26.8
Cash flow from operations	15.3	38.1

    During 2009 the company *most likely* decreased the:

    A. proportion of sales made on a cash basis.
    B. inventory, anticipating lower demand for its products in 2010.
    C. proportion of interest-bearing debt relative to trade accounts payable.

47. According to International Financial Reporting Standards which of the following is one of the conditions that *must* be met for revenue recognition to occur?

    A. Costs can be reliably measured
    B. Payment has been partially received
    C. Goods have been delivered to the customer

48. A company accrued wages of $2,000 and collected accounts receivable of $10,000. Which of the following *best* describes the effect of these two transactions on the company?

    A. Net income will increase
    B. Current ratio will decrease
    C. Cash from operations will decrease

49. A company had 100,000 common shares outstanding on 1 January 2009. The company has no plans to issue additional shares or purchase treasury shares during the year, but is planning either a two-for-one stock split or a 100 percent stock dividend on 1 July. The number of shares used to determine earnings per share at 31 December 2009, will be *closest* to:

A. 200,000 for both the stock split and the stock dividend.
B. 200,000 for the stock split and 150,000 for the stock dividend.
C. 150,000 for the stock split and 200,000 for the stock dividend.

50. Under International Financial Reporting Standards (IFRS) the preparation of a complete set of financial statements is *best* described as a(n):

A. objective of financial reporting.
B. general requirement for financial statements.
C. qualitative characteristic of the IFRS Framework.

51. Which of the following transactions will *most likely* result in a decrease in a company's current ratio? The:

A. recording of a warranty expense.
B. recording of revenue before cash is received.
C. payment of a property insurance policy for the following year.

52. A company issued bonds in 2009 that mature in 2019. The measurement basis that will *most likely* be used on the 2009 balance sheet for the bonds is:

A. market value.
B. historical cost.
C. amortized cost.

53. Which of the following transactions is *least* likely to increase a company's reported cash from operations?

A. Securitizing accounts receivable
B. Delaying payments made to suppliers
C. Using short-term debt to reduce an existing account payable

54. The settlement value for a liability is *best* described as:

A. the amount of proceeds received in exchange for the obligation.
B. the discounted value of the future cash flows that are required to satisfy the obligation.
C. the undiscounted amount of cash or cash equivalents expected to be paid to satisfy the obligation.

55. A company has just completed the sale of a tract of land for €3.5 million which was originally acquired at a cost of €2.0 million. The purchaser made a down-payment of €200,000 with the remainder to be paid in equal installments over the next 10 years. A short time after the sale, significant doubt arose about the purchaser's ability to meet the future obligations for the land purchase. When compared to the cost recovery method of revenue recognition, the profit (in €) that the company will recognize in the year of the sale under the installment method is *most likely* to be higher by:

A. 85,714.
B. 114,286.
C. 150,000.

56. Presented below are abbreviated balance sheets for two merchandising companies following the format found in each of their annual reports.

Company A (in $ U.S. Millions)			**Company B (in ¥ Millions)**	
Assets			**Assets**	
Noncurrent assets	9,640		Current Assets	4,333
Current Assets	2,096		Noncurrent assets	19,923
Total Assets	11,736		Total Assets	24,256
Shareholders' Equity			**Liabilities & Shareholders' Equity**	
Issued Capital	2,490		Current liabilities	2,413
Retained Earnings	1,333		Non-Current Liabilities	6,847
Other Reserves	2,926			
Minority Interests	506		Minority Interests	1,045
Total Equity	7,255			
			Shareholders' Equity	
Non-Current Liabilities	3,313		Issued Capital	5,149
Current liabilities	1,168		Retained Earnings	2,755
Total Liabilities	4,481		Other Reserves	6,047
			Total Equity	13,951
Total Equity & Liabilities	11,736		Total Equity & Liabilities	24,256

Which of the companies *most likely* prepares their financial statements in accordance with U.S. GAAP (generally accepted accounting principles)?

A. Both
B. Company A only
C. Company B only

57. An analyst makes the appropriate adjustments to the financial statements of retail companies that are lessees using a substantial number of operating leases. Compared to ratios computed from the unadjusted statements, the ones computed from the adjusted statements would *most likely* be higher for:

A. the debt-equity ratio but not the interest coverage ratio.
B. the interest coverage ratio but not the debt-equity ratio.
C. both the debt-equity ratio and the interest coverage ratio.

58. To gain insight into what portion of a company's assets is liquid, an analyst will *most likely* use:

A. the cash ratio.
B. the current ratio.
C. common-size balance sheets.

59. An analyst gathers the following information ($ millions) about three companies operating in the same industry:

Company	Annual Depreciation Expense	Accumulated Depreciation
1	10.8	58.9
2	27.8	80.3
3	33.6	128.8

Although the companies have different levels of sales and assets, they are all experiencing sales growth at about the same rate and use the same type of equipment in the manufacturing process. All three companies also use the same depreciation method. Which company is *least likely* to require major capital expenditures in the near future? Company:

A. 1.
B. 2.
C. 3.

60. The following information (U.S. $ millions) for two companies operating in the same industry during the same time period is available:

	Company A	Company B
Net sales	120	300
Total assets	70	140
Total liabilities	25	40

If both companies achieve a return on equity of 15% for the period, which of the following statements is *most likely* correct? Compared to Company B, Company A has a:

A. higher net profit margin.
B. higher total asset turnover.
C. lower financial leverage multiplier.

61. Is the reversal of an inventory write-down permitted under U.S. GAAP (generally accepted accounting principles) and International Financial Reporting Standards (IFRS)?

A. No, under both
B. Yes, under both
C. Yes under IFRS but not under U.S. GAAP

62. A retail company prepares its financial statements in accordance with U.S. GAAP (generally accepted accounting principles). Its purchases and sales of inventory for its first two years of operations are listed below.

	First Year	Second Year
Units Purchased	80,000	100,000
Unit Cost	$8.43	$12.25
Units Sold	73,000	78,000
Unit Selling Price	$15.00	$16.00

In its second year of operation, the company's ending inventory is $348,003. Which of the following inventory cost flow assumptions is the company was *most likely* using?

A. FIFO
B. LIFO
C. Weighted average cost

63. A company issued a $50,000 7-year bond for $47,565. The bonds pay 9 percent per annum and the yield-to-maturity at issue was 10 percent. The company uses the effective interest rate method to amortize any discounts or premiums on bonds. After the first year, the yield to maturity on bonds equivalent in risk and maturity to these bonds is 9 percent. The amount of the bond discount amortization ($) recorded in the second year is *closest* to:

A. 282.
B. 348.
C. 2,178.

64. The following selected information is from a company's most recent financial statements:

	(£ millions)	
	2009	**2008**
Sales	2,801	2,885
Cost of Goods Sold	1,969	2,071
Interest Expense	123	110
Cash & Marketable Securities	108	105
Accounts Receivable	318	286
Inventories	248	285
Accounts Payable	361	346
Notes Payable	50	99

The 2009 cash conversion cycle, in days, is *closest* to:

A. 23.
B. 26.
C. 28.

65. In the evaluation of credit ratings, a company will *most likely* be assigned a higher credit rating if it has a:

A. lower EBITDA/Interest ratio.
B. lower dividends-to-total-debt ratio.
C. higher five year average of its coefficient of variation of its operating margin.

66. A company purchased a €2,000 million long-term asset in 2009 when the corporate tax rate was 30 percent.

Asset year end value for (All figures in € millions.)	**2010**	**2009**
Accounting purposes	1,800	1,900
Tax purposes	1,280	1,600

On January 15, 2010 the government lowered the corporate tax rate to 25 percent for 2010 and beyond. The deferred tax liability (€) as at 31 December 2010 is *closest* to:

A. 130.
B. 156.
C. 205.

67. Which of the following is *least likely* a condition present in a "fraud triangle"?

A. Constraining debt covenants.
B. Adding independent members to the Board of Directors.
C. Management's belief that a decline in performance is due to temporary economic conditions.

68. A company is buying back its stocks to offset the dilution of earnings from its stock option program. Which of the following statements *best* describes the effect on the financial statements of the amount spent to buy back the stocks? The amount spent reduces:

A. net income.
B. cash from operating activities.
C. cash from financing activities.

Questions 69 through 78 relate to Corporate Finance

69. A company is determining the cost of debt for use in its weighted average cost of capital. It has recently issued a 10-year, 6 percent semi-annual coupon bond for $864. The bond has a maturity value of $1,000. If the marginal tax rate is 35 percent, the cost of debt (%) they should use in their calculation is *closest* to:

    A. 2.6.
    B. 3.9.
    C. 5.2.

70. The post-audit performed as part of the capital budgeting process is *least likely* to:

    A. improve a firm's operations.
    B. produce concrete ideas for future investments.
    C. force management to revise the original forecast to match actual results.

71. A company is considering building a distribution center on undeveloped land that it acquired more than ten years ago at a cost of $400,000. The company estimates the cost of putting in utilities, sewers, roads and other such costs of preparing the land for the distribution center at $200,000. Alternatively, the undeveloped land could be sold today to another company for $600,000. In evaluating this capital project, the investment outlay associated with the use of the land by the distribution center will *most likely* be:

    A. $400,000.
    B. $600,000.
    C. $800,000.

72. When considering capital projects, which of the following statements is *most* accurate? Compared to the NPV method, the IRR method:

    A. can result in multiple values.
    B. has the more appropriate reinvestment rate assumption.
    C. uses more accurate estimates of the project's cash flows.

73. A company wants to determine the cost of equity to use in the calculation of its weighted average cost of capital. The CFO has gathered the following information:

Rate of return on 3-month Treasury bills	3.0%
Rate of return on 10-year Treasury bonds	3.5%
Market equity risk premium	6.0%
The company's estimated beta	1.6
The company's after-tax cost of debt	8.0%
Risk premium of equity over debt	4.0%
Corporate tax rate	35%

Using the bond-yield-plus-risk-premium approach, the cost of equity (%) for the company is *closest* to:

A. 12.0.
B. 16.3.
C. 18.3.

74. A publicly listed company has a 12-person Board of Directors whose composition is as follows:

- the Chairman, who is the past president of the company and was named Chairman on his retirement date four years ago,
- five members of senior management including the current president, and
- six outside directors.

Each member is elected for a two-year term and one-half of the positions stand for election every year. The three members of the Audit Committee are all outside directors and have relevant financial experience. The Remuneration Committee is composed of the Chairman and two outside directors. Which of the following actions would provide the *greatest* improvement in the corporate governance of this company?

A. The Chairman of the Board should be an independent director.
B. All members of the Board of Directors should stand for election every year.
C. The company's Vice-President of Finance should be a member of the audit committee.

75. Which of the following methods would be *least* likely to improve the cash collections of a retail organization?

A. Lockbox
B. Debit cards
C. Electronic checks

76. Assuming current assets and current liabilities remain a constant proportion of sales (30 percent and 20 percent respectively), as sales grow 5 percent annually, through time the current ratio will *most likely*:

A. increase.
B. decrease.
C. remain unchanged.

77. Which is *least likely* to be a component of a developing country's equity premium?

A. Sovereign yield spread
B. Annualized standard deviation of the developing country's equity index
C. Annualized standard deviation of the sovereign bond market in terms of the developing country's currency

78. A company extends its trade credit terms by four days to all its credit customers. The *most likely* effect of this change to the company's credit customers is a four day:

A. increase in their operating cycle.
B. decrease in their operating cycle.
C. decrease in their net operating cycle.

Questions 79 through 90 relate to Equity Investments

79. The issue of differences in accounting conservatism between companies is *best* addressed when companies are compared using which of the following ratios?

    A. Price-to-earnings
    B. Price-to-cash flow
    C. Price-to-book value

80. A continuous market *most likely* exists for a stock when:

    A. specialists or market makers attempt to derive new equilibrium prices in an orderly manner.
    B. new information about the company prospects is continuously released to market participants.
    C. trades occur at any time the market is open wherein stocks are priced either by auction or by dealers.

81. Capital market efficiency is desirable, but there are limitations to achieving full market efficiency. Which of the following is *least likely* to be a limitation to achieving full capital market efficiency?

    A. Survivorship bias
    B. Limits of arbitrage
    C. Cost of information

82. A price-weighted index series is composed of the following three stocks:

Stock	*Number of Shares Outstanding Before Stock Split*	*Market Price Before Split Day 1*	*Market Price After Split Day 3*
X	1,000,000	$10	$12
Y	5,000,000	$20	$19
Z	4,000,000	$60	$22

If stock Z completes a three-for-one stock split at the end of Day 1, the value of the index after the split (at the end of Day 3) is *closest* to:

    A. 29.9.
    B. 31.7.
    C. 32.3.

83. An analyst gathers the following information about a company:

Net profit margin	8.0%
Return on assets	10.0%
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 15% without changing its capital structure or issuing new equity, the company’s maximum dividend payout ratio (in %) is *closest* to:

A. 25.
B. 40.
C. 60.

84. A company has furnished the following information:

Return on equity	20%
Earnings retention rate	50%
Current dividend per share (D_o) paid on the company’s common stock	€2.00
Required rate of return on the company’s common stock	15%
Current stock price	€50
Company’s P/E ratio	30x
Industry average P/E ratio	20x
Stock’s beta	0.7

According to the dividend discount model and the other data given, the company’s stock is *best* described as a:

A. growth stock.
B. cyclical stock.
C. speculative stock.

85. An investor opens a margin account with an initial deposit of $5,000. He then purchases 300 shares of a stock at $30. His margin account has a maintenance margin requirement of 30%. Ignoring commissions and interest, the price (in $) at which the investor receives a margin call is *closest* to:

A. 19.05.
B. 23.08.
C. 23.81.

86. The following information is from a company's most recent financial statements:

U.S. $ in millions except for shares outstanding and tax rate	
Preferred stock	40
Common stock	120
Additional paid-in capital	30
Retained earnings	190
Treasury stock	(55)
Total shareholders' equity	325
Total number of common shares outstanding	10 million
Tax rate	40%

The company uses the LIFO inventory method. The footnotes to the financial statements indicate that if the company had used the FIFO method, the inventory balance would have been $45 million higher than the amount reported on the company's most recent financial statements. If the company's common stock is currently selling for $59 per share, the company's adjusted price-to book-value ratio is *closest* to:

A. 1.67.
B. 1.79.
C. 1.89.

87. An investor gathers the following data for a company:

Net profit margin	2%
Total assets	$200 million
Total liabilities	$120 million
Net income	$10 million
Dividends paid on common stock	$2 million

The company's estimated dividend growth rate (in %) is *closest* to:

A. 8.0.
B. 10.0
C. 12.5.

88. A company's $100 par perpetual preferred stock has a dividend rate of 7 percent and a required rate of return of 11 percent. The company's earnings are expected to grow at a constant rate of 3 percent per year. If the market price per share for the preferred stock is $75, the preferred stock is *most* appropriately described as being:

A. overvalued by $11.36.
B. undervalued by $15.13.
C. undervalued by $36.36.

89. An equity analyst working for a growth oriented mutual fund has a tendency to misvalue the stocks of popular companies that she has previously recommended and the fund already owns. Her behavior is *most likely* consistent with which of the following biases?

A. Escalation bias
B. Prospect theory
C. Confirmation bias

90. A company earned $3 a share last year and just paid a dividend of $2 a share. The company's dividends are expected to grow by 8 percent annually for the next two years. An investor with an 11 percent required rate of return expects to sell the stock at $75 two years from now. The maximum amount the investor should be willing to pay for this company's stock (in $) today is *closest* to:

A. 58.68.
B. 64.71.
C. 66.63.

Questions 91 through 96 relate to Derivative Investments.

91. When the underlying stock price is $95, an investor pays $2 for a call option with an exercise price of $95. If the stock price moves to $96, the intrinsic value of the call option would be *closest* to:

    A. -$1.
    B. $0.
    C. $1.

92. Margin in the futures market is *most* accurately described as a:

    A. loan to the futures trader.
    B. requirement set by federal regulators.
    C. down payment from the futures trader.

93. A derivative is *most* accurately defined as a financial instrument that provides:

    A. a return based on the return of another asset.
    B. an adjustment to another asset's level of risk.
    C. an agreement between two parties to provide something for each other.

94. An investor enters into a 1 X 3 forward rate agreement (FRA) at a LIBOR rate of 1.5 percent. At expiration, the 60-day LIBOR rate is 1.7 percent and the 90-day LIBOR rate is 1.6 percent. Assuming the contract covers a $1 million notional principal, what payment will the investor *most likely* receive?

    A. $249.00
    B. $332.39
    C. $333.33

95. In comparison to a forward contract, a futures contract is *most likely* to be **less**:

    A. liquid.
    B. publicized.
    C. customized.

96. In what way is the payoff of a forward rate agreement (FRA) *most likely* different from the payoff of an interest rate option?

    A. It is based on a fixed exercise rate.
    B. It is based on a notional principal amount.
    C. It is paid immediately when the contract expires.

Questions 97 through 108 relate to Fixed Income Investments.

97. An analyst determines that a 5.50 percent coupon option-free bond, maturing in 7 years, would experience a 3 percent decrease in price if market interest rates rise by 50 basis points. If market interest rates instead fall by 50 basis points, the bond's price would increase by:

    A. exactly 3%.
    B. less than 3%.
    C. more than 3%.

98. Holding all other factors constant, an increase in expected yield volatility will cause the price of a:

    A. putable bond to increase.
    B. callable bond to increase.
    C. putable bond to decrease.

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

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

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

    A. 4.6 years.
    B. 7.5 years.
    C. 9.2 years.

100. According to the market segmentation theory, an upward sloping yield curve is *most likely* due to:

    A. investor expectations that short-term interest rates will fall in the future.
    B. different levels of supply and demand for short-term and long-term funds.
    C. an increasing yield premium required by investors for bearing interest rate risk.

101. An 8 percent coupon bond with a par value of $100 matures in 2 years and is selling at $98.24 to yield 9 percent. Exactly one year ago this bond sold at a price of $95.03 to yield 10 percent. The bond pays annual interest. The change in price attributable to the change in maturity is *closest* to:

A. $1.50.
B. $3.21.
C. $4.97.

102. A fixed income portfolio manager owns a $5 million par value non-callable bond. The bond's duration is 5.6 and the current market value is $5,125,000. The dollar duration of the bond is *closest* to:

A. $280,000.
B. $287,000.
C. $700,000.

103. Two amortizing bonds have the same maturity date and same yield to maturity. The reinvestment risk for an investor holding the bonds to maturity is *greatest* for the bond that is:

A. a zero-coupon bond.
B. a coupon bond selling at a discount to par.
C. a coupon bond selling at a premium to par value.

104. If investors expect stable rates of inflation in the future, the pure expectations theory suggests that the yield curve is currently:

A. flat.
B. inverted.
C. upward-sloping.

105. A portfolio of option-free bonds is *least likely* to be exposed to:

A. volatility risk.
B. yield curve risk.
C. reinvestment risk.

106. An investor purchases a 5 percent coupon bond maturing in 3 years for $102.80, providing a yield-to-maturity of 4 percent. At what rate must the coupon payments be reinvested to generate the 4 percent yield?

A. 0%
B. 4%
C. 5%

107. The yield of a U.S. bond issue quoted on a bond-equivalent basis is 6.8 percent. The yield-to-maturity on an annual-pay basis is *closest* to:

A. 6.69%.
B. 6.92%
C. 14.06%.

108. Given the data in the table below, the price of a 3% coupon corporate bond maturing in 2 years is closest to:

Period	**Years to Maturity**	**Spot Rate (%)**	**Corporate Spread (%)**
1	0.5	3.00	0.50
2	1.0	3.30	0.50
3	1.5	3.50	0.50
4	2.0	4.00	0.50

A. $97.19.
B. $98.12.
C. $100.04.

Questions 109 through 114 relate to Alternative Investments.

109. A variation of which real estate valuation approach is *most likely* to use slope coefficients derived from a statistical analysis to estimate the value of a property?

A. Cost approach.
B. Income approach.
C. Sales comparison approach.

110. An investor has gathered the following data, presented on an annual basis, for an apartment complex that is being considered for purchase:

Potential income (net of vacancy and collection losses)	$180,000
Insurance and taxes	$15,000
Utilities	$10,000
Repairs and maintenance	$18,000
Depreciation	$21,000
Interest on proposed financing	$16,000

The annual net operating income (NOI) for the apartment complex is *closest* to:

A. $116,000.
B. $121,000.
C. $137,000.

111. Hedge funds that contain infrequently traded assets would *most likely* exhibit a downward bias with respect to:

A. measured risk but not correlations with conventional equity investments.
B. correlations with conventional equity investments but not measured risk.
C. both measured risk and correlations with conventional equity investments.

112. When the spot price of a commodity is above the futures price, the commodity market is said to be in:

A. contango.
B. full carry.
C. backwardation.

113. When investing in commodities through a collateralized commodity futures position, the return associated with rolling forward the maturity of a futures contract is referred to as the:

A. collateral yield.
B. spot price return.
C. convenience yield.

114. A typical hedge fund fee structure is *least likely* to include a:

A. base fee.
B. high water mark.
C. negative incentive fee.

Questions 115 through 120 relate to Portfolio Management.

115. Factors such as fluctuations in interest rates and changes in industrial production contribute to:

    A. systematic risk.
    B. unsystematic risk.
    C. both systematic and unsystematic risk.

116. When assessing the performance of a single investment fund, the asset allocation decision explains:

    A. a little less than 100% of the level of a fund's returns.
    B. about 90% of the fund's variation in returns across time.
    C. an average of 40% of the variation in returns of a fund across time.

117. According to the Capital Asset Pricing Model (CAPM) if investors borrow at a rate that exceeds the risk-free lending rate the resulting borrowing portfolios will:

    A. plot on a flatter line.
    B. plot on a steeper line.
    C. no longer plot on a straight line.

118. Which of the following is **not** an assumption of the Markowitz model? Investors:

    A. have homogeneous expectations.
    B. maximize one-period expected utility.
    C. base decisions solely on expected return and risk.

119. The table below provides a probability distribution of stock returns for shares of Orion Corporation:

Probability	**Rate of Return (%)**
0.15	-12
0.60	11
0.25	18

    The variance of returns for Orion Corporation stock is *closest* to:

    A. 44.36
    B. 50.94
    C. 88.71

120. For a retired 65-year-old investor, with moderate risk tolerance and adequate insurance and cash reserves, the appropriate portfolio will *most likely* have the following mix of bonds and stocks:

	Bonds	**Stocks**
A	55-65%	35-45%
B	30-40%	60-70%
C	15-50%	50-85%