

2012 Level I Mock Exam: Afternoon Session

The afternoon session of the 2012 Level I Chartered Financial Analyst (CFA®) 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

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Questions 1 through 18 relate to Ethical and Professional Standards

1. As a condition of his employment with an investment bank, Abasi Hasina, CFA, was required to sign an employment contract, including a non-compete clause restricting him from working for a competitor for three years after leaving the employer. After one year, Hasina quits his job for a comparable position with an investment bank in a country where non-compete clauses are illegal. Lawyers with whom he consulted prior to taking the new position determined the non-compete clause was a violation of human rights and thus illegal. Did Hasina *most likely* violate the CFA Institute Code of Ethics?
 - A. Yes
 - B. No, because the non-compete clause violates his human rights
 - C. No, because the non-compete clause is illegal in the new country of employment
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 the CFA Institute Global Investment Performance Standards (GIPS®)?
 - A. Independent verification firms
 - B. The firm claiming compliance
 - C. The performance measurement 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 publishes a “buy” recommendation. He defends his actions by stating he has done nothing wrong because Dunfield does not 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.

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5. Zhao Xuan, CFA, is a sell side investment analyst. While at a software industry conference, Zhao hears rumors that Green Run Software may have falsified its financial results. When she returns to her office, Zhao conducts a thorough analysis of Green Run. Based on her research, including discussions with some of Green Run's customers, Zhao is convinced that Green Run's reported 50% increase in net income during recent quarters is completely fictitious. So far, however, Zhao is the only analyst suspicious about Green Run's reported earnings. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, the *least* appropriate action for Zhao is to:
- A. report her suspicions to Green Run's management.
 - B. do nothing, until other analysts support her analysis.
 - C. recommend her clients sell their Green Run shares immediately.
6. Richard Cardinal, CFA, is the founder of Volcano Capital Research, 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 lobbying firms to update him immediately on any legislative or regulatory changes that may impact his target companies. Cardinal sells short those target companies he estimates are near the peak of their sales and earnings and that his 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. 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 a webcast open to all institutional but not retail clients, Kelso states "even though my name is on the sell reports, these stocks are a buy in part because sales and share prices for both auto companies will rise significantly due to strong demand for their vehicles." Kelso's actions would *least likely* violate which of the following CFA Institute Standards of Professional Conduct?
- A. Fair Dealing
 - B. Communication with Clients
 - C. Diligence and Reasonable Basis

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8. Gardner Knight, CFA, is a product development specialist at an investment bank. Knight is responsible for creating and marketing 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 “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 of the following CFA Institute Standards of Professional Conduct?
- A. Suitability
 - B. Conflicts of Interest
 - C. Client Communication
9. Monique Gretta, CFA, is a research analyst at East West Investment Bank. Previously, Gretta worked at a mutual fund management company and has a long-standing client relationship with the managers of the funds and their institutional investors. Gretta often provides fund managers, who work for Gretta’s former employer, 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 bank’s clients, even though they are not aware of this practice. 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. this practice benefits all clients.
 - C. the long-standing client relationships are not disclosed.
10. Colin Caldwell, CFA, is the chief investment officer of Northwest Mutual Fund, whose investment objective is to invest in fixed income emerging market securities. Caldwell allocates the fund’s assets primarily to bonds of commodity producers in emerging markets and invests in a combination of several different investments to ensure an acceptable level of risk. The allocation is clearly disclosed in all fund communications. High volatility in the commodities markets at the start of the year makes Caldwell pessimistic about returns, so he shifts the fund into emerging market and U.S. government securities, positions he maintains at the end of the year. This change is noted in the next annual report to fund shareholders. Caldwell’s investment change *least likely* violated the CFA Institute Code of Ethics and Standards of Professional Conduct concerning:
- A. diversification.
 - B. communication with clients.
 - C. investments outside his mandate.

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11. Robin Herring, CFA, is a government bond research analyst at an independent credit rating agency. A competitor credit rating agency just downgraded the bonds of a government Herring follows. Herring notes all of the information in the competitor's report was covered in his analysis published last week. In the past, Herring has been slow to downgrade bonds, so he starts to doubt his own analysis after seeing the competitor's report. Herring decides to reissue his credit rating of this government bond and match the competitor's downgrade. In his revised report, Herring states that new information has been made available to justify the downgrade. Herring posts the revision on the credit rating agency's website and provides it by e-mail to all clients who received the original. Herring's rating change *least likely* violated which of the following CFA Institute Code of Ethics and Standards of Professional Conduct?
- A. Fair Dealing
 - B. Communication with Clients
 - C. Diligence and Reasonable Basis
12. Dorian Solot, CFA, is responsible for a team of research analysts at Apac Bank, located in a country with strict laws prohibiting intellectual property transfers. Solot believes the work of one of her analysts, Blaine Paddock, CFA, is not completed as carefully and thoroughly as it should be. Solot completely reviews all of Paddock's research and confirms her suspicions. Solot then confronts Paddock about his poor quality research and tells him he can leave Apac voluntarily or be fired. Paddock chooses to leave the bank, walking out with his personal papers and research notes that were created prior to his joining Apac. Subsequently, Paddock uses this intellectual property to help establish a high-net-worth investment advisory firm. When a prospective client asks Paddock if he left Apac because of questions on the quality of his work, Paddock says it was to start his own business. Paddock *least likely* violated the CFA Institute Standards of Professional Conduct concerning his:
- A. research.
 - B. intellectual property.
 - C. prospective client disclosure.
13. Oliver Opdyke, CFA, works for an independent research organization that does not manage any client money. In the course of his analysis of Red Ribbon Mining he hears rumors the president of Red Ribbon, Richard Leisberg, has recently been diagnosed with late stage Alzheimer's disease, a fact not publicly known. The final stage of Alzheimer's is when individuals lose the ability to respond to their environment, the ability to speak, and, ultimately, the ability to control movement. Leisberg is the charismatic founder of Red Ribbon, and under his leadership the company grew to become one of the largest in the industry. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, the *most* appropriate action for Opdyke is to:
- A. immediately publish a sell recommendation for Red Ribbon Mining.
 - B. confirm the president's diagnosis before publishing his research report.
 - C. encourage Red Ribbon Mining management to disclose the president's medical condition.

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14. Raymond Ortiz, CFA, provides investment advice to high-net-worth investors. Ortiz has just completed an analysis of Continental Wheat, a manufacturer of wheat-based food products. He rated the company a long-term hold for investors seeking growth and income. Ortiz's analysis included a review of the company's management team, financial data, pro forma financial positions, dividends and dividend policy, and a comparison of Continental with its competitors. Although he does not tell anyone, five years ago, Ortiz worked for and managed the commodities derivatives trading unit of Continental. As part of his compensation at Continental, he received stock, which he still owns. Based upon his research, Ortiz recommends Continental to clients who have a moderate risk tolerance. Two weeks later Continental announces its quarterly earnings are 30% less than a year ago. Consequently, shares of Continental drop by 50%. Ortiz *most likely* violated the CFA Institute Code of Ethics and Standards of Professional Conduct related to his stock:
- A. research.
 - B. ownership.
 - C. recommendation.
15. Carolina Ochoa, CFA, is the chief financial officer at Pantagonia Computing. Ochoa is currently the subject of an inquiry by Pantagonia's corporate investigations department. The inquiry is the result of an anonymous complaint accusing Ochoa of falsifying travel expenses for senior management related to a government contract. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, it is *most* appropriate for Ochoa to disclose the allegations:
- A. on her Professional Conduct Statement.
 - B. to CFA Institute when the investigation concludes.
 - C. to CFA Institute if the allegations are proven correct.
16. Belen Zapata, CFA, is the owner of Kawah Investments. Kawah promises investors returns of up to 12% per year and claims to achieve this by investing in non-investment-grade bonds and other fixed income instruments. Over the next 12 months, bond market yields reach unprecedented lows and Zapata finds it impossible to achieve the returns she expected. No investments are ever made by Kawah, and clients are completely paid back all of their original investment. Zapata *most likely* violated the CFA Institute Standards of Professional Conduct because of the:
- A. return of capital.
 - B. promised returns.
 - C. investment mandate.

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17. Jan Loots, CFA, quit his job as a portfolio manager at an investment firm with whom he had a non-solicitation agreement he signed several years ago. Loots received permission to take his investment performance history with him and also took a copy of the firm's software-trading platform. Subsequently, Loots sent out messages on social media sites announcing he was looking for clients for his new investment management firm. Access to Loots' social media sites is restricted to friends, family, and former clients. Loots *least likely* violated the CFA Institute Standards of Professional Conduct concerning his:
- A. trading software.
 - B. non-solicitation agreement.
 - C. investment performance history.
18. Chan Liu, CFA, is the new research manager at the Pacific MicroCap Fund. Liu observed the following activities after she published a research report on a thinly traded micro cap stock that included a "buy" recommendation:
- Pacific traders purchased the stock for Pacific's proprietary account and then purchased the same stock for all client accounts; and
 - Pacific marketing department employees disseminated positive, but false, information about this stock in widely read Internet forums.
- Liu notes the stock's price increased more than 50% within a period of two days and was then sold for Pacific's account. Which of the following steps is *most* appropriate for Liu to take to avoid violating the CFA Institute Code of Ethics and Standards of Professional Conduct?
- A. Report the observed activities to her employer.
 - B. Remove her name from the micro cap stock research report.
 - C. Publicly refute the false information posted on Internet forums.

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Questions 19 through 32 relate to Quantitative Methods

19. An analyst has established the following prior probabilities regarding a company's next quarter's earnings per share (EPS) exceeding, equaling, or being below the consensus estimate.

	Prior probabilities
EPS exceed consensus	25%
EPS equal consensus	55%
EPS are less than consensus	20%

Several days before releasing its earnings statement, the company announces a cut in its dividend. Given this information, the analyst revises his opinion regarding the likelihood that the company will have EPS below the consensus estimate. He estimates the likelihoods the company will cut the dividend given that EPS exceed/meet/fall below consensus as reported below.

	Probabilities the company cuts dividends conditional on EPS exceeding/equaling/falling below consensus
P(Cut div EPS exceed)	5%
P(Cut div EPS equal)	10%
P(Cut div EPS below)	85%

Bayes' formula:

Updated probability of event given the new information

$$= \frac{\text{Probability of the new information given event}}{\text{Unconditional probability of the new information}} \times \text{Prior probability of event}$$

Using Bayes' formula (given above), the updated (posterior) probability that the company's EPS are below the consensus is *closest* to:

- A. 24%.
 - B. 72%.
 - C. 85%.
20. If the distribution of the population from which the samples are drawn is positively skewed, and given that the sample size is large, the sampling distribution of the sample means is *most likely*:
- A. approximately normally distributed.
 - B. to have a variance equal to that of the entire population.
 - C. to have a mean smaller than the mean of the entire population.

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21. A project offers the following incremental after-tax cash flows:

Year	0	1	2	3	4
Cash flow (€)	-12,500	2,000	4,000	5,000	2,000

The appropriate discount rate to use in evaluating the project is 8%. The NPV (in €) of the project is *closest* to:

- A. -1,780.
- B. -1,736.
- C. -922.

22. Given the following portfolio 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%.

23. Given the following information about three portfolios:

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

If the risk-free rate is 4%, which portfolio has the *highest* Sharpe ratio?

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

24. 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 *best* described as:

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

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25. Assume that the real risk-free rate of return is 3% and that the expected inflation premium is 5%. If the risk premium incorporates default risk, liquidity risk, and any maturity premium, an observed (nominal) interest rate of 12% implies that the risk premium is *closest* to:
- A. 4%.
 - B. 8%.
 - C. 10%.
26. When considering two mutually exclusive capital budgeting projects with conflicting rankings (one has the higher positive NPV, the other has a higher IRR), the *most* appropriate conclusion is to choose the project with the:
- A. higher IRR.
 - B. higher NPV.
 - C. shorter payback.
27. A low price range in which buying activity is sufficient to stop a price decline is *best* described as:
- A. support.
 - B. resistance.
 - C. change in polarity.
28. An investor purchases one share of stock for \$85. Exactly one year later, the company pays a dividend of \$2.00 per share. This is followed by two more annual dividends of \$2.25 and \$2.75 in successive years. Upon receiving the third dividend, the investor sells the share for \$100. The money-weighted rate of return on this investment is *closest* to:
- A. 7.97%.
 - B. 8.15%.
 - C. 8.63%.
29. Independent samples drawn from normally distributed populations exhibit the following characteristics:

Sample	Size	Sample mean	Sample standard deviation
A	25	200	45
B	18	185	60

Assuming that the variances of the underlying populations are equal, the pooled estimate of the sample variance is 2,678.05. The *t*-test statistic appropriate to test the hypothesis that the two population means are equal is *closest* to:

- A. 0.29.
- B. 0.94.
- C. 1.90.

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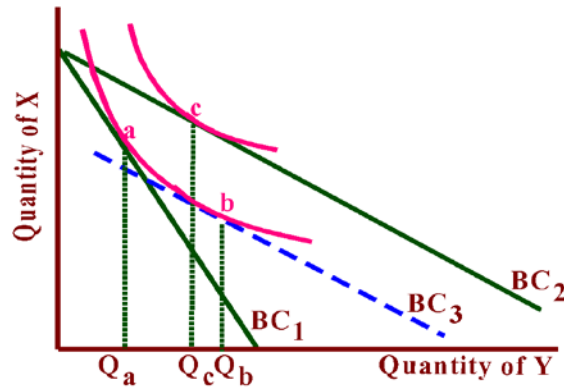
30. Which of the following *most* accurately describes how to standardize a random variable X ?
- A. Subtract the mean of X from X , and then divide that result by the standard deviation of X .
 - B. Subtract the mean of X from X , and then divide that result by the standard deviation of the standard normal distribution.
 - C. Divide X by the difference between the standard deviation of X and the standard deviation of the standard normal distribution.
31. For planning purposes, an individual wants to be able to spend €80,000 per year, at the end of each year, for an anticipated 25 years in retirement. In order to fund this retirement account, he will make annual deposits of €6,608 at the end of each of his working years. What is the minimum number of such deposits he will need to make to fund his desired retirement? Use 6% interest compounded annually for all calculations.
- A. 29 payments
 - B. 40 payments
 - C. 51 payments
32. A technical analyst has detected a price chart pattern with three segments. The left segment shows a decline followed by a reversal to the starting price level. The middle segment shows a more pronounced decline than in the first segment and again a reversal to near the starting price level. The third segment is roughly a mirror image of the first segment. This chart pattern is *most* accurately described as:
- A. a triple bottom.
 - B. a head and shoulders.
 - C. an inverse head and shoulders.

Questions 33 through 44 relate to Economics

33. Consumer surplus is *best* described as:
- 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.

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34. The diagram illustrates a consumer's allocation of her budget between items X and Y. With an initial budget (BC_1) she consumes Q_a units of item Y. When the price of Y drops, she consumes Q_c units of item Y. Lines BC_2 and BC_3 are parallel to one another.



The income effect arising from this change in the price of Y is *best* described as the distance between:

- A. Q_b and Q_a .
 - B. Q_c and Q_b .
 - C. Q_c and Q_a .
35. If the minimum efficient scale of a single producer is small relative to the demand for an undifferentiated good, the market structure of the producer is *best* described as being:
- A. an oligopoly.
 - B. perfect competition.
 - C. monopolistic competition.
36. In regard to the aggregate demand curve and an increase in one of its associated factors, which of the following relationships is *least* accurate?

	Increase in factor	Shifts the AD curve	Reason
A.	Stock prices	Rightward	Lower investment
B.	Consumer confidence	Rightward	Higher consumption
C.	Exchange rate*	Leftward	Lower exports and higher imports
*Exchange rate is foreign currency per unit of domestic currency			

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37. Holding the working-age population constant, if the labor force participation ratio declines while the number of people employed remains unchanged, the unemployment rate will *most likely*:
- A. increase.
 - B. decrease.
 - C. remain unchanged.
38. Which of the following statements is *most* accurate? For a country to gain from trade it *must* have:
- A. an absolute advantage.
 - B. a comparative advantage.
 - C. economies of scale or lower labor costs.
39. The following equations have been developed for a company:

Demand curve	$P = 150 - 5 \times Q$
Total revenue curve	$TR = 150 \times Q - 5 \times Q^2$
Marginal revenue curve	$MR = 150 - 10 \times Q$
Total cost curve	$TC = Q^3 - 10 \times Q^2 + 73 \times Q + 120$
Average cost curve	$AC = Q^2 - 10 \times Q + 73 + 120/Q$
Marginal cost curve	$MC = 3 \times Q^2 - 20 \times Q + 73$
P: price per unit Q: cost per unit	

- The profit maximizing output for this firm (in units) is *closest* to:
- A. 7.
 - B. 8.
 - C. 11.
40. Which of the following government interventions in market forces is *most likely* to cause overproduction?
- A. Price floors
 - B. Price ceilings
 - C. Imposing an additional per-unit tax of \$1 on sellers

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41. In an effort to influence the economy, a central bank conducted open market activities by selling government bonds. This implies that the central bank is *most likely* attempting to:
- A. contract the economy by reducing bank reserves.
 - B. expand the economy through a lower policy interest rate.
 - C. contract the economy through a lower policy interest rate.
42. Consider two countries, A and B. Country A is a closed country with a relative abundance of labor and holds a comparative advantage in the production of textiles. Country B has a relative abundance of capital. When the textile trade is opened between the two countries, Country A will *most likely* experience a favorable impact on:
- A. labor.
 - B. capital.
 - C. both capital and labor.
43. Four countries operate within a customs union. One country proposes moving to a common market structure. What additional level of economic integration between the countries would *most likely* arise if this change took place? They would:
- A. establish common trade barriers against non-members.
 - B. begin to allow free movement of the factors of production.
 - C. establish common economic institutions and coordination of economic policies.
44. The current spot rate for the USD/EUR is 0.7500. The forward rate for the EUR/Australian dollar (AUD) is 1.4300, which represents a 400 point forward premium to the spot rate (scaled up by four decimal places). The USD/AUD spot rate is *closest* to:
- A. 1.0296.
 - B. 1.0425.
 - C. 1.1154.

Questions 45 through 68 relate to Financial Statement Analysis

45. Which of the following is *least likely* to appear in a company's proxy statement?
- A. Compensation arrangements for management and directors
 - B. Significant events and contingencies that may affect future operations
 - C. Potential conflicts of interest between management, directors, and shareholders

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46. At the start of the year, a company's capital contributed by owners and retained earnings accounts had balances of \$10,000 and \$6,000, respectively. During the year, the following events took place:

Net income earned	\$4,000
Interest paid on debt	\$ 500
Repayment of long-term debt	\$1,000
Proceeds from shares issued	\$1,000
Dividends paid	\$ 600

The end of year owners' equity is *closest* to:

- A. \$19,400.
 - B. \$19,900.
 - C. \$20,400.
47. A retailer provides credit cards only to its most valued customers who pass a rigorous credit check. A credit card customer ordered an item from the retailer in May. The item was shipped and delivered in July. The item appeared on the customer's July credit card statement and was paid in full by the due date in August. The *most* appropriate month in which the retailer should recognize the revenue is:
- A. May.
 - B. July.
 - C. August.

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48. Selected information from a company's recent income statement and balance sheets is presented below.

**Selected Income Statement Data
for the year ended December 31st
(Can \$ thousands)**

	<u>2011</u>
Sales	\$2,240,000
Cost of goods sold	<u>1,320,000</u>
Gross profit	920,000
Net Income	\$316,600

**Selected Balance Sheet Data
as of December 31st
(Can \$ thousands)**

	<u>2011</u>	<u>2010</u>
Assets		
Cash & investments	\$210,700	\$191,600
Accounts receivable	212,800	201,900
Inventories	<u>63,000</u>	<u>71,500</u>
Total current assets	\$486,500	\$465,000
Liabilities		
Accounts payable	\$129,600	\$157,200
Other current liabilities	<u>130,700</u>	<u>182,700</u>
Total current liabilities	\$260,300	\$339,900

The company operates in an industry in which suppliers offer terms of 2/10, net 30. The payables turnover for the average company in the industry is 8.5 times. Which of the following statements is *most* accurate? In 2011, the company on average:

- A. took advantage of early payment discounts.
 - B. paid its accounts within the payment terms provided.
 - C. paid its accounts more promptly than the average firm in the industry.
49. Which of the following will *most likely* result in an increase in a company's sustainable growth rate?
- A. Higher tax burden ratio
 - B. Lower interest burden ratio
 - C. Higher dividend payout ratio

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50. During 2010, the following events occurred at a company. The company:

1.	purchased a customer list for \$100,000, which is expected to provide equal annual benefits for the next 4 years.
2.	recorded \$200,000 of goodwill in the acquisition of a competitor. It is estimated that the acquisition would provide substantial benefits for the company for at least the next 10 years.
3.	spent \$300,000 on media placements announcing the company had donated products and services to the community. The CEO believes the firm's reputation was enhanced substantially and the company will likely benefit from it for the next 5 years.

Based on those events, the amortization expense that the company should report in 2011 is *closest* to:

- A. \$25,000.
- B. \$45,000.
- C. \$85,000.

51. The following items are from a company's cash flow statement.

Classification of cash flow	Description	Amount (£000s)
Operating activities	Cash received from customers	55,000
Investing activities	Interest and dividends received	10,000
Financing activities	Net repayment of revolving credit loan	12,000

Which of the following standards and formats did the company *most likely* use in the preparation of its financial statements?

- A. IFRS, direct format
- B. IFRS, indirect format
- C. Either IFRS or U.S. GAAP, direct format

52. The following information is available about a manufacturing company:

	\$ million
Cost of ending inventory computed using FIFO	4.3
Net realizable value	4.1
Current replacement cost	3.8

If the company is using International Financial Reporting Standards (IFRS), instead of U.S. GAAP, its cost of goods sold (\$ millions) is *most likely*:

- A. the same.
- B. 0.3 lower.
- C. 0.3 higher.

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53. For which of the following assets is it *most* appropriate to test for impairment at least annually?
- A. Land
 - B. A patent with a legal life of 20 years
 - C. A trademark with an expected indefinite life

54. On 1 January 2011 the market rate of interest on a company's bonds is 5% and it issues a bond with the following characteristics:

Face value	€50 million
Coupon rate, paid annually	4%
Time to maturity	10 years (31 December 2020)
Issue price (per €100)	92.28

If the company uses IFRS, its interest expense (in millions) in 2011 is *closest* to:

- A. €1.846.
 - B. €2.307.
 - C. €2.386.
55. Given the following information about a company:

(€ millions)	2011	2010
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
Operating 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.
56. 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.

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57. The *least likely* reason that a security analyst needs to understand the accounting process is to:
- A. prevent earnings manipulation by management.
 - B. make adjustments to reflect items not reported in the financial statements.
 - C. aid in the assessment of management's judgment in accruals and valuations.
58. What is the *most likely* effect on the accounting equation when a company purchases office equipment with cash?
- A. Assets increase, and liabilities increase.
 - B. There is no effect on the accounting equation.
 - C. Assets decrease, and owners' equity decreases.
59. Which of the following statements *best* describes the role of the International Organization of Securities Commissions (IOSCO)? The IOSCO:
- A. is responsible for regulating financial markets of member nations.
 - B. is the oversight body to which the International Accounting Standards Board (IASB) reports.
 - C. assists in attaining the goal of cross-border cooperation in combating violations of securities laws.

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60. The following data are available for a company and its industry:

Company Common-Size Balance Sheet As at 31 December 2010	
Assets	(%)
Cash & Short-Term Investments	43.2
Accounts Receivable	9.4
Inventory	<u>0.6</u>
Total Current Assets	53.2
Net Property, Plant, and Equipment	3.9
Goodwill	40.0
Other Long-Term Assets	<u>2.9</u>
Total Assets	<u>100.0</u>
Liabilities and Shareholders' Equity	
Short-Term Debt	1.6
Accrued Liabilities and Accounts Payable	<u>17.8</u>
Total Current Liabilities	19.4
Long-Term Debt	20.1
Other Long-Term Liabilities	<u>6.5</u>
Total Liabilities	46.0
Total Stockholders' Equity	<u>54.0</u>
Total Liabilities & Shareholders' Equity	<u>100.0</u>

Data for comparison	Industry
Current ratio	3.0
Debt-to-equity	50.0%
Long-term debt-to-equity	40.0%

Which of the following statements about the company is *most* appropriate? The company:

- A. operates in the manufacturing industry.
- B. has made significant acquisitions in the past.
- C. has higher financial leverage than the industry.

61. Which of the following is *least likely* a benefit of the direct method for reporting cash flow from operating activities? Compared with the indirect method, the direct method provides:

- A. supplementary data under U.S. GAAP.
- B. details on the specific sources of operating receipts and payments.
- C. insight on differences between net income and operating cash flows.

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62. A firm reported the following financial statement items:

Cash Flow Item	(€)
Net income	2,100
Non-cash charges	400
Interest expense	300
Capital expenditure	210
Working capital expenditures	0
Net borrowing	1,600
Tax rate	40%

The free cash flow to the firm is *closest* to:

- A. €2,110.
- B. €2,470.
- C. €2,590.

63. An analyst gathers the following information about a company's common stock:

- 1 January 2011 200,000 shares outstanding
- 1 June 2011 50,000 shares issued
- 1 August 2011 2 for 1 stock split
- 31 December 2011 500,000 shares outstanding

To calculate earnings per share for 2011, the company's weighted average number of shares outstanding is *closest* to:

- A. 333,333.
- B. 350,000.
- C. 458,333.

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

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

65. A company's information from its first year of operation is as follows:

Event	2011	
	Units	NZ\$/unit
Opening inventory	0	0
Purchase #1	1,000	\$22.50
Purchase #2	800	\$25.00
Purchase #3	400	\$25.50
Sales	1,700	\$40.00

Using a periodic inventory system and the weighted average method, the ending inventory value is *closest* to:

- A. \$11,975.
 - B. \$12,165.
 - C. \$12,700.
66. A company purchased equipment for \$50,000 on 1 January 2009. It is depreciating the equipment over a period of 10 years on a straight-line basis for accounting purposes, but for tax purposes, it is using the declining balance method at a rate of 20%. Given a tax rate of 30%, the deferred tax liability as at the end of 2011 is *closest* to:
- A. \$420.
 - B. \$2,820.
 - C. \$6,720.

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67. An analyst is analyzing two companies in the same industry and believes that they have similar strategies regarding the use of property, plant, and equipment (PP&E). He also thinks that the PP&E assets of the two companies are roughly of the same age and have the same expected useful lives remaining. Company A uses the LIFO method of inventory valuation, and Company B uses the FIFO method. The following additional information is available from the companies' financial statements:

	\$ millions	
	Company A	Company B
Current assets	5,800	6,300
Inventory LIFO reserve	1,100	N/A
Current liabilities	4,300	4,200
Gross PP&E	2,500	3,000
Accumulated depreciation	1,250	1,200
Depreciation expense	125	120

In the analyst's opinion, which of the following conclusions is *most* appropriate? Compared with Company A, Company B:

- A. is more liquid.
 - B. has a higher quality of earnings.
 - C. uses more aggressive accounting estimates related to PP&E.
68. An analyst has made three observations in his worksheets about a company that he is reviewing. Which of the observations *most likely* reduces the quality of earnings of the company? The company:
- A. reported for the first time an asset titled "Deferred customer acquisition costs."
 - B. has reduced its estimate of the expected useful life of computer equipment from 8 years to 5 years.
 - C. entered into long-term leases for its manufacturing equipment instead of purchasing it and recorded the leases as capital leases.

Questions 69 through 78 relate to Corporate Finance

69. A firm's estimated costs of debt, preferred stock, and common stock are 12%, 17%, and 20%, respectively. Assuming equal funding from each source and a 40% tax rate, the weighted average cost of capital is *closest* to:
- A. 13.9%.
 - B. 14.7%.
 - C. 16.3%.

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70. Which of the following is *most likely* considered an example of matrix pricing?

- A. Debt-rating approach only
- B. Yield-to-maturity approach only
- C. Both the yield-to-maturity and the debt-rating approaches

71. 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%

72. 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 \$4,000 annual commitment fee
- C. Commercial paper at 5.9% annually with a dealer's annual commission of \$1,500 and a backup line annual cost of \$3,500

73. Using the firm's income statement presented, its degree of financial leverage is *closest* to:

Income Statement	\$ millions
Revenues	10.2
Variable Operating Costs	4.6
Fixed Operating Costs	2.0
Operating Income	3.6
Interest	1.2
Taxable Income	2.4
Tax	1.0
Net Income	1.4

- A. 1.5.
- B. 1.7.
- C. 2.6.

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74. The “per unit contribution margin” for a product is \$12. Assuming fixed costs of \$12,000, interest costs of \$3,000, and taxes of \$2,000, the operating breakeven point (in units) is *closest* to:
- A. 1,000.
 - B. 1,250.
 - C. 1,417.

75. Which of the following capital budgeting techniques is *most* directly related to stock price?
- A. Net present value
 - B. Profitability index
 - C. Discounted payback period

76. A company’s data are furnished below:

Cost of debt	10%
Cost of equity	16%
Debt-to-equity ratio (D/E)	50%
Tax rate	30%

The weighted average cost of capital (WACC) is *closest* to:

- A. 11.5%.
 - B. 13.0%.
 - C. 14.0%.
77. For a 90-day U.S. Treasury bill selling at a discount, which of the following methods *most likely* results in the highest yield?
- A. Money market yield
 - B. Discount-basis yield
 - C. Bond equivalent yield
78. In a sales-driven pro forma analysis, net income grows from \$1.2 million to \$1.26 million. Assuming a dividend payout ratio of 40%, the increase in retained earnings is *closest* to (in \$ millions):
- A. 0.720.
 - B. 0.756.
 - C. 1.260.

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Questions 79 through 90 relate to Equity Investments

79. The index weighting that results in portfolio weights shifting away from securities that have increased in relative value (e.g., decrease in book-to-market) toward securities that have fallen in relative value whenever the portfolio is rebalanced is *most* accurately described as:
- A. equal weighting.
 - B. fundamental weighting.
 - C. float-adjusted market-capitalization weighting.
80. According to the industry life-cycle model, an industry in the shakeout stage is *best* characterized as experiencing:
- A. slowing growth and intense competition.
 - B. little or no growth and industry consolidation.
 - C. relatively high barriers to entry and periodic price wars.
81. An investor uses the data below and Gordon's constant growth dividend discount model to evaluate a company's common stock. To estimate growth, she uses the average value of the:
- 1) compounded annual growth rate over the period 2006–2011 and
 - 2) sustainable growth rate for the year 2011.

Year	EPS	DPS	ROE
2011 2010	\$3.20	\$1.92	12%
2009 2008	\$3.60	\$1.85	17%
2007	\$2.44	\$1.74	13%
2006	\$2.08	\$1.62	15%
	\$2.76	\$1.35	11%
	\$2.25	\$1.25	9%

If her required return is 15%, the stock's intrinsic value is *closest* to:

- A. \$23.71.
 - B. \$25.31.
 - C. \$30.14.
82. According to behavioral finance, observed overreaction in securities markets *most likely* occurs due to:
- A. loss aversion.
 - B. gambler's fallacy.
 - C. disposition effect.

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83. Companies pursuing cost leadership will *most likely*:
- A. invest in productivity-improving capital equipment.
 - B. engage in defensive pricing when the competitive environment is one of high rivalry.
 - C. establish strong market research teams to match customer needs with product development.

84. The following data pertain 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%.
85. A trader seeking to sell a very large block of stock, or a piece of urban real estate property, for her client will *most likely* execute the trade in a(n):
- A. brokered market.
 - B. order-driven market.
 - C. quote-driven market.
86. Accounting standards and reporting requirements that produce meaningful and timely financial disclosures are *most* critical for achieving which of the following efficiencies associated with a well-functioning financial system?
- A. Operational
 - B. Allocational
 - C. Informational
87. Arbitrage activity will *most likely* be higher in securities markets:
- A. that are efficient.
 - B. with no restrictions on short selling.
 - C. with high information-acquisition costs.

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88. An analyst collects the following data on the return on equity (ROE) and the payout ratio for two companies, M and N. Using a required return of 12.4% for both companies, she computes the justified forward P/E ratios, which are also given below.

Company	Return on equity (%)	Payout ratio (%)	Justified forward P/E
M	12.0	30	7.5
N	14.0	40	10.0

If Company M increases its dividend payout ratio to 40% and Company N decreases its dividend payout ratio to 30%, which of the following will *most likely* occur? The justified P/E ratio of:

- A. both companies would increase.
 - B. both companies would decrease.
 - C. Company M would increase but that of Company N would decrease.
89. A fund manager gathers the following data in order to assess a stock's potential for a possible addition to her portfolio:

Company's net income	\$20 million
Company's equity at the beginning of the year	\$140 million
Company's weighted average cost of capital (WACC)	10.75%
Stock's beta	1.80
Market risk premium	5.25%
Risk-free rate	3.50%
Fund manager's required rate of return	13.60%

Which of the following is the *most* appropriate decision for the fund manager?

- A. Do not invest in the stock.
 - B. Invest in the stock because the company's ROE is greater than the required rate of return.
 - C. Invest in the stock because the required rate of return is greater than the company's WACC.
90. An observation that stocks with above average price-to-earnings ratios have consistently underperformed those with below average price-to-earnings ratios *least likely* contradicts which form of the market efficiency?
- A. Weak form
 - B. Strong form
 - C. Semi-strong form

Questions 91 through 96 relate to Derivative Investments

91. When purchasing a futures contract, the initial margin requirement refers to the:
- A. minimum account balance required as prices change.
 - B. performance bond ensuring fulfillment of the obligation.
 - C. amount needed to finance the purchase of the underlying asset.
92. A buyer would face the *greatest* risk of default with:
- A. a farmer making physical delivery on a short soybean futures position.
 - B. an investment bank making cash settlement on a short euro futures position.
 - C. a multinational firm making cash settlement on a short U.S. dollar forward contract.
93. Which of the following statements *most* closely relates to the concept of moneyness?
- A. The sum of money the option buyer pays the seller is called the premium.
 - B. Both call and put option prices decline as the time to expiration becomes shorter.
 - C. One would never exercise a call option if the price of the underlying is below the strike price.
94. The intrinsic value of an option is always zero:
- A. at expiration.
 - B. when its time value is zero.
 - C. when it is out-of-the-money.
95. Euribor would *most likely* be the interest rate quoted on a large:
- A. euro time deposit in Toronto.
 - B. dollar time deposit in Frankfurt.
 - C. euro dollar time deposit in the United States.
96. The *least likely* way to terminate a swap is to:
- A. purchase and exercise a swaption.
 - B. pay the market value to the counterparty.
 - C. sell an offsetting swap listed on an exchange.

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Questions 97 through 108 relate to Fixed Income Investments

97. Which of these embedded options *most likely* benefits the investor?
- A. The floor in a floating-rate security
 - B. An accelerated sinking fund provision
 - C. The call option in a fixed-rate security
98. 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. highest coupon rate.
 - C. coupon rate closest to its market yield.
99. Duration is *most* accurate as a measure of interest rate risk for a bond portfolio when the slope of the yield curve:
- A. increases.
 - B. decreases.
 - C. stays the same.
100. An investor whose marginal tax rate is 33.5% is analyzing a tax-exempt bond offering a yield of 5.20%. The taxable-equivalent yield of the bond is *closest* to:
- A. 3.90%.
 - B. 6.94%.
 - C. 7.82%.
101. If the yield on a 5-year U.S. corporate bond is 7.39% and the yield on a 5-year U.S. Treasury note is 4.26%, the relative yield spread of the bond is *closest* to:
- A. 3.13%.
 - B. 42.40%
 - C. 73.50%.
102. Consider a \$100 par value bond, with an 8% coupon paid annually, maturing in 20 years. If the bond currently sells for \$96.47, the yield to maturity is *closest* to:
- A. 7.41%.
 - B. 8.29%.
 - C. 8.37%.

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103. Consider two ten-year bonds, one that contains no embedded options and the other that gives its owner the right to convert the bond to a fixed number of shares of the issuer's common stock. The convertibility option in the second bond cannot be exercised for five years. The bonds are otherwise identical. Compared with the yield on the convertible bond, the yield on the option-free bond is *most likely*:

- A. lower.
- B. higher.
- C. the same.

104. Using the U.S. Treasury spot rates provided below, the arbitrage-free value of a 2-year Treasury, \$100 par value bond with a 6% coupon rate is *closest* to:

Period	Years	Spot Rate
1	0.5	1.60%
2	1.0	2.20%
3	1.5	2.70%
4	2.0	3.10%

- A. \$99.75.
- B. \$105.65.
- C. \$107.03.

105. Consider three bonds that have the same yield to maturity and maturity. The bond with the greatest reinvestment risk is *most likely* the one selling at:

- A. par.
- B. a discount.
- C. a premium.

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106. Using the U.S. Treasury forward rates provided below, the value of a 2½-year, \$100 par value Treasury bond with a 5% coupon rate is *closest* to:

Period	Years	Forward Rate
1	0.5	1.20%
2	1.0	1.80%
3	1.5	2.30%
4	2.0	2.70%
5	2.5	3.00%

- A. \$101.52.
B. \$104.87.
C. \$106.83.
107. If three bonds are otherwise identical, the one exhibiting the highest level of positive convexity is *most likely* the one that is:
- A. puttable.
B. callable.
C. option-free.
108. The table below provides information about a portfolio of three bonds.

Bond	Maturity	Price	Par Amount	Duration
1	17-year	\$109.2461	\$16 million	8.56
2	20-year	\$100.4732	\$4 million	9.19
3	25-year	\$84.6427	\$8 million	11.48

Based on this information, the duration of the portfolio is *closest* to:

- A. 9.35.
B. 9.48.
C. 9.74.

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Questions 109 through 114 relate to Alternative Investments

109. Which of the following *least likely* describes an advantage of investing in hedge funds through a fund of funds? A fund of funds may provide investors with:
- A. lower fees due to economies of scale.
 - B. access to funds that are closed to new investors.
 - C. access to managers with expertise in finding reliable and good-quality hedge funds.
110. Compared with investment in an open-ended index mutual fund, which of these is *least likely* a benefit to an investor in an index exchange traded fund (ETF) on the same index?
- A. Lower bid–ask spreads
 - B. Managing the timing of capital gains
 - C. Ability to sell short and buy on margin
111. Which of the following is *least likely* an aggregation vehicle for real estate ownership?
- A. Leveraged equity rights
 - B. Real estate investment trusts (REITs)
 - C. Real estate limited partnerships (RELPs)
112. An investor might consider investments in commodities because, historically, commodity returns have had a higher positive correlation with:
- A. inflation.
 - B. bond returns.
 - C. stock returns.
113. Do base management fees *most likely* get paid to the manager of a hedge fund regardless of the fund's performance?
- A. Yes
 - B. No, only when the fund's gross return is positive
 - C. No, only when the fund's net asset value exceeds the previous high water mark
114. The three main sources of return for commodities-related investments are:
- A. collateral yield, roll yield, and spot price return.
 - B. collateral yield, convenience yield, and roll yield.
 - C. convenience yield, dividend yield, and spot price return.

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Questions 115 through 120 relate to Portfolio Management

115. The execution step of the portfolio management process includes:

- A. finalizing the asset allocation.
- B. monitoring the portfolio performance.
- C. preparing the investment policy statement.

116. A correlation matrix of the returns for securities A, B, and C is reported below:

Security	A	B	C
A	1.0		
B	0.5	1.0	
C	0.0	-0.5	1.0

Assuming that the expected return and the standard deviation of each security are the same, a portfolio consisting of an equal allocation of which two securities will be *most effective* for portfolio diversification? Securities:

- A. A and B.
- B. A and C.
- C. B and C.

117. The slope of the security market line (SML) represents the portion of an asset's expected return attributable to:

- A. total risk.
- B. market risk.
- C. diversifiable risk.

118. Last year, a portfolio manager earned a return of 12%. The portfolio's beta was 1.5. For the same period, the market return was 7.5% and the average risk-free rate was 2.7%. Jensen's alpha for this portfolio is *closest to*:

- A. 0.75%.
- B. 2.10%.
- C. 4.50%.

119. Information about three stocks is provided below:

Stock	Expected Return	Beta
Booraem Inc.	12.85%	1.5
Heisen Inc.	11.27%	1.1
Gutmann Inc.	9.51%	0.8

If the expected market return is 9.5% and the average risk-free rate is 1.2%, according to the capital asset pricing model (CAPM) and the security market line (SML), which of the three stocks is *most likely* overvalued?

- A. Heisen Inc.
- B. Booraem Inc.
- C. Gutmann Inc.

120. In a strategic asset allocation, assets within a specific asset class are *least likely* to have:

- A. low paired correlations.
- B. high paired correlations.
- C. low correlations with other asset classes.

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